

# **Exhibit**

# **12**

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**SUPERIOR COURT OF THE STATE OF CALIFORNIA**  
**FOR THE COUNTY OF LOS ANGELES**

RETIREMENT HOUSING FOUNDATION;) CASE NO. BC404726  
FOUNDATION PROPERTY MANAGEMENT,) [Hon. Lee Smalley Edmon, Dept. 322]  
INC; BIXBY KNOLLS TOWERS, INC.; GOLD)  
COUNTRY HEALTH CENTER, INC.;) **SIXTH AMENDED COMPLAINT FOR:**  
MAYFLOWER GARDENS HEALTH)  
FACILITIES, INC.; MAYFLOWER RHF) 1. NEGLIGENCE  
HOUSING, INC.; SUN CITY RHF HOUSING;) 2. NEGLIGENT  
HOLLY HILL RHF HOUSING, INC.; MERRITT) MISREPRESENTATION  
ISLAND RHF HOUSING, INC.; MARTIN) 3. BREACH OF FIDUCIARY DUTY  
LUTHER FOUNDATION, INC.;) 4. CONSTRUCTIVE FRAUD  
YELLOWWOOD ACRES, INC.; BLUEGRASS) 5. FRAUD AND DECEIT  
RHF HOUSING, INC.; ST. CATHERINE RHF) 6. NEGLIGENT  
HOUSING, INC., and DESMET RHF HOUSING,) MISREPRESENTATION  
INC.,) 7. UNFAIR COMPETITION  
8. FRAUD, DECEIT AND  
Plaintiffs,) CONSPIRACY TO DEFRAUD  
9. NEGLIGENT  
vs.) MISREPRESENTATION  
10. INTENTIONAL INTERFERENCE  
CAIN BROTHERS & CO. LLC; ACA) WITH PROSPECTIVE ECONOMIC  
FINANCIAL GUARANTY CORPORATION;) ADVANTAGE  
RICHARD S. FULD, JR.; CHRISTOPHER M.) 11. FRAUD AND DECEIT  
O'MEARA; ERIN M. CALLAN; MICHAEL L.) 12. NEGLIGENT  
AINSLIE; JOHN F. AKERS; ROGER S.) MISREPRESENTATION  
BERLIND; THOMAS H. CRUIKSHANK;) **DEMAND FOR JURY TRIAL**  
MARSHA JOHNSONEVANS; CHRISTOPHER)  
GENT; ROLAND A. HERNANDEZ; HENRY)  
KAUFMAN; JOHN D. MACOMBER, and DOES) **Complaint Filed: December 30, 2008**  
1-10 and 13-140, inclusive,) **Trial Date: Not set**  
Defendants.)

AND RELATED CROSS-ACTION

**ALLEGATIONS COMMON TO ALL CAUSES OF ACTION**

**I. The Parties**

1. Plaintiff Retirement Housing Foundation (“RHF”) is, and at all times relevant to this Sixth Amended Complaint was, a California not-for-profit corporation with its principal place of business in Long Beach, California.

2. Plaintiff Foundation Property Management, Inc. (“FPM”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of Los Angeles in the State of California.

3. Plaintiff Bixby Knolls Towers, Inc. (“Bixby Knolls”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of Los Angeles in the State of California.

4. Plaintiff Gold Country Health Center, Inc. (“Gold Country”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of El Dorado in the State of California.

5. Plaintiff Mayflower Gardens Health Facilities, Inc. (“Mayflower Health”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of Los Angeles in the State of California.

6. Plaintiff Mayflower RHF Housing, Inc. (“Mayflower I”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of Los Angeles in the State of California.

7. Plaintiff Sun City RHF Housing, Inc. (“Sun City”) is, and at all times relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws of the State of California and doing business in the County of Riverside in the State of California.

1           8.       Plaintiff Holly Hill RHF Housing, Inc. (“Holly Hill”) is, and at all times relevant to  
2 this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the  
3 laws of the State of Florida and doing business in the State of Florida.

4           9.       Plaintiff Merritt Island RHF Housing, Inc. (“Merritt Island”) is, and at all times  
5 relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing  
6 under the laws of the State of Florida and doing business in the State of Florida.

7           10.      Plaintiff Martin Luther Foundation, Inc. (“Martin Luther”) is, and at all times relevant  
8 to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under  
9 the laws of the State of Florida and doing business in the State of Florida.

10          11.      Plaintiff Yellowwood Acres, Inc. (“Yellowwood”) is, and at all times relevant to this  
11 Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws  
12 of the State of Indiana and doing business in the State of Indiana.

13          12.      Plaintiff Bluegrass RHF Housing, Inc. (“Bluegrass”) is, and at all times relevant to  
14 this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the  
15 laws of the State of Kentucky and doing business in the State of Kentucky.

16          13.      Plaintiff St. Catherine RHF Housing, Inc. (“St. Catherine”) is, and at all times  
17 relevant to this Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing  
18 under the laws of the State of Missouri and doing business in the State of Missouri.

19          14.      Plaintiff DeSmet RHF Housing, Inc. (“DeSmet”) is, and at all times relevant to this  
20 Sixth Amended Complaint was, a not-for-profit corporation incorporated and existing under the laws  
21 of the State of Missouri and doing business in the State of Missouri.

22          15.      Defendant Cain Brothers & Co., LLC (“Cain Brothers”) is, and at all times relevant  
23 to this Sixth Amended Complaint was, a limited liability company organized in Delaware and whose  
24 principal place of business is in the State of New York and who does business in the State of  
25 California.

26          16.      Defendant ACA Financial Guaranty Corporation (“ACA”) is, and at all times relevant  
27 to this Sixth Amended Complaint was, a Maryland corporation whose principal place of business  
28 is in the State of New York and who does business in the State of California.

1           17. Defendant Richard S. Fuld, Jr. ("Fuld") is the former Chairman of the Board of  
2 Directors and Chief Executive Officer of Lehman Brothers Holdings, Inc. On Plaintiffs' information  
3 and belief, Fuld is, and at all times relevant to this Sixth Amended Complaint was, an individual  
4 residing in the State of New York.

5           18. Christopher M. O'Meara ("O'Meara") is the former Chief Financial Officer,  
6 Controller and Chief Risk Officer of Lehman Brothers Holdings, Inc. On Plaintiffs' information and  
7 belief, O'Meara is, and at all times relevant to this Sixth Amended Complaint was, an individual  
8 residing in the State of New York.

9           19. Erin M. Callan ("Callan") is the former Chief Financial Officer and Controller of  
10 Lehman Brothers Holdings, Inc. On Plaintiffs' information and belief, Callan is, and at all times  
11 relevant to this Sixth Amended Complaint was, an individual residing in the State of New York.

12           20. Michael L. Ainslie ("Ainslie") is a former member of the Board of Directors of  
13 Lehman Brothers Holdings, Inc. On Plaintiffs' information and belief, Ainslie is, and at all times  
14 relevant to this Sixth Amended Complaint was, an individual residing in the State of Florida.

15           21. John F. Akers ("Akers") is a former member of the Board of Directors of Lehman  
16 Brothers Holdings, Inc. On Plaintiffs' information and belief, Akers is, and at all times relevant to  
17 this Sixth Amended Complaint was, an individual residing in the State of Connecticut.

18           22. Roger S. Berlind ("Berlind") is a former member of the Board of Directors of Lehman  
19 Brothers Holdings, Inc. On Plaintiffs' information and belief, Berlind is, and at all times relevant  
20 to this Sixth Amended Complaint was, an individual residing in the State of New York.

21           23. Thomas H. Cruikshank ("Cruikshank") is a former member of the Board of Directors  
22 of Lehman Brothers Holdings, Inc. On Plaintiffs' information and belief, Cruikshank is, and at all  
23 times relevant to this Sixth Amended Complaint was, an individual residing in the State of Texas.

24           24. Marsha Johnson Evans ("Evans") is a former member of the Board of Directors of  
25 Lehman Brothers Holdings, Inc. On Plaintiffs' information and belief, Evans is, and at all times  
26 relevant to this Sixth Amended Complaint was, an individual residing in the District of Columbia.

27           25. Christopher Gent ("Gent") is a former member of the Board of Directors of Lehman  
28 Brothers Holdings, Inc. On Plaintiffs' information and belief, Gent is, and at all times relevant to

1 this Sixth Amended Complaint was, an individual residing in the United Kingdom.

2 26. Roland A. Hernandez (“Hernandez”) is a former member of the Board of Directors  
3 of Lehman Brothers Holdings, Inc. On Plaintiffs’ information and belief, Hernandez is, and at all  
4 times relevant to this Sixth Amended Complaint was, an individual residing in the State of  
5 California.

6 27. Henry Kaufman (“Kaufman”) is a former member of the Board of Directors of  
7 Lehman Brothers Holdings, Inc. On Plaintiffs’ information and belief, Kaufman is, and at all times  
8 relevant to this Sixth Amended Complaint was, an individual residing in the State of New Jersey.

9 28. John D. Macomber (“Macomber”) is a former member of the Board of Directors of  
10 Lehman Brothers Holdings, Inc. On Plaintiffs’ information and belief, Macomber is, and at all times  
11 relevant to this Sixth Amended Complaint was, an individual residing in the District of Columbia.

12 29. Fuld, O’Meara, Callan, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez,  
13 Kaufman and Macomber are hereinafter sometimes referred to collectively as “The Individual  
14 Lehman Defendants.” Fuld, O’Meara, Callan are hereinafter sometimes referred to collectively as  
15 the “Officer Defendants.” Fuld, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez,  
16 Kaufman and Macomber are hereinafter sometimes referred to collectively as the “Director  
17 Defendants.”

18 30. On Plaintiffs’ information and belief, each of the Individual Lehman Defendants have  
19 done business in the State of California in their personal capacity and/or on behalf of Lehman  
20 Brothers Holdings, Inc. and its subsidiaries, including Lehman Brothers, Inc., Lehman Brothers  
21 Special Financing, Inc., and Lehman Government Securities, Inc., and their representatives. Lehman  
22 Brothers Holdings, Inc. and its subsidiaries are hereinafter sometimes collectively referred to as  
23 “Lehman Brothers.”

24 31. The true names and capacities, whether individual, corporate, or otherwise, of  
25 Defendants DOES 1 through 10 and 13-140 are unknown to Plaintiffs, and Plaintiffs therefore sue  
26 these Defendants by their fictitious names and capacities. Plaintiffs will amend this Sixth Amended  
27 Complaint to allege these defendants’ true names and capacities when the same have been  
28 ascertained.

1           32. On Plaintiffs' information and belief, DOES 1 through 10, inclusive, have acted or  
2 failed to act in concert with Cain Brothers as alleged herein, and are responsible in some manner for  
3 the injuries and damages suffered by Plaintiffs. All references to Cain Brothers herein shall be  
4 deemed to include Does 1 through 10.

5           33. On Plaintiffs' information and belief, DOES 13 through 20, inclusive, have acted or  
6 failed to act in concert with ACA as alleged herein, and are responsible in some manner for the  
7 injuries and damages suffered by Plaintiffs. All references to ACA herein shall be deemed to include  
8 Does 13 through 20.

9           34. On Plaintiffs' information and belief, DOES 21 through 140, inclusive, have acted  
10 or failed to act in concert with the Individual Lehman Defendants as alleged herein, and are  
11 responsible in some manner for the injuries and damages suffered by Plaintiffs. All references to  
12 the Individual Lehman Defendants herein shall be deemed to include Does 21 through 140.

13 **II. Cain Brothers' Plan Of Refinancing**

14           35. RHF is a church-related, non-profit organization devoted to the mission of providing  
15 safe and affordable housing and services for senior citizens, persons with disabilities, and low  
16 income families. Although its headquarters are in Southern California, RHF has sponsored,  
17 developed and/or managed senior citizen apartments, nursing facilities, and low income housing  
18 throughout the country.

19           36. Cain Brothers is an investment banking and financial and strategic advisory firm that,  
20 at all times relevant herein, focused exclusively on the health care industry, and whose client base  
21 included nonprofit health care service providers and managed care companies such as Plaintiffs.

22           37. On or about July 24, 1998, RHF, from its headquarters in California, issued a written  
23 "Request for Proposal" to several investment banking firms including Cain Brothers to solicit  
24 proposals "for investment banking services" to "structure" a multi-state, multi-facility group that  
25 would issue approximately \$140 million in taxable and tax exempt bonds to refinance its existing  
26 debt. The Request for Proposal specifically requested proposals that would "keep[] down the costs  
27 and the long term cost of the deal," and address RHF's "probable need for credit enhancement," but  
28 otherwise provided wide latitude for the solicited investment banking firms to design and structure

1 any proposed plan of refinancing. Attached as Exhibit A is a true and correct copy of the Request  
2 for Proposal sent to Cain Brothers.

3 38. On or about July 31, 1998, Cain Brothers (along with Ziegler Securities (“Ziegler”)  
4 and Banc One Capital Markets, Inc. (“Banc One”)) responded in writing to RHF’s Request for  
5 Proposal and proposed to structure a highly complicated, long-term, 30-year plan of refinancing for  
6 Plaintiffs, underwrite bonds to be issued for their benefit, and sell those bonds in the capital markets.  
7 Within its proposal, among other things, Cain Brothers committed to the dual role of underwriting  
8 the bonds and providing Plaintiffs with financial and strategic advice and expertise regarding the  
9 development, management, structuring of the long-term complex plan of refinancing. Cain Brothers  
10 represented that it had the expertise to safely, efficiently and at a low cost arrange and structure the  
11 proposed long term plan of refinancing in accordance with Plaintiffs’ stated goals and provide proper  
12 financial and strategic advice and expertise over the course of that plan. A true and correct copy of  
13 Cain Brothers’ proposal is attached as Exhibit B.

14 39. Originally Ziegler had intended to submit Cain Brothers’ proposal alone, but because  
15 certain key Ziegler representatives (Joan Annett, Amy Hayman, and Scott Smith) had recently or  
16 were about to defect to Cain Brothers, the initial proposal, Exhibit B, was a joint proposal. Ziegler  
17 soon dropped out of the transaction entirely when Scott Smith left Ziegler for Cain Brothers in the  
18 later summer or early fall of 1998, and Cain Brothers thereafter took over Ziegler’s respective  
19 positions, duties, and responsibilities. At the time the Financial Advisory Agreement was entered,  
20 Banc One was a minority investor in Cain Brothers, but also eventually dropped out, with Cain  
21 Brothers assuming its contractual duties and acting as Plaintiffs’ sole financial and strategic advisor  
22 in connection with the transaction.

23 40. Cain Brothers’ proposal provided that, if it was accepted, Cain Brothers would  
24 “function” as “Special Products agents for the RHF Obligated Group refinancing as well [as] . . .  
25 sharing in the principal risk portions of the Special Products proposed to be used for the RHF  
26 Obligated Group refinancing.” The proposal further promised, among other things, that its plan  
27 would “minimize the RHF Obligated Group’s cost of capital while actually increasing its flexibility  
28 to raise future capital for new growth and expansion activities;” that it would reduce RHF and



1 affiliates' costs of debt; that the interest rate savings available were considerable; and that the plan  
2 would "provide the necessary protection to RHF of taking swap counterparty risk." Cain Brothers'  
3 proposal further promised to provide Plaintiffs with "post-closing" support. Pursuant to Cain  
4 Brothers' proposal, Cain Brothers promised to provide the RHF Group with a broad range of  
5 predevelopment, coordination, financial advisory and underwriting tasks and assistance, including  
6 but not limited to the following explicit duties:

7 (a) To be "responsible for overall strategy and structure of the financing";

8 (b) To be responsible for "negotiating terms of rating and credit enhancement";

9 (c) To be "responsible for underwriting Cain Brothers principal risk position  
10 taken on special products utilized";

11 (d) To be "responsible for day-to-day coordination of legal team, issuers, credit  
12 enhancement and rating process";

13 (e) To be "responsible for ensuring the bond structure is compatible with the  
14 proposed special products structure";

15 (f) To be "responsible for ensuring the bond structure and special products  
16 structure promotes future flexibility for credit, bridge, financing, etc.";

17 (g) To be "responsible for providing technical analysis of bond sizings, credit  
18 enhancement costs, analyses for rating agencies, credit enhancers, etc.;

19 (h) To be "responsible for ensuring the cost efficiency and risk management of  
20 special products structures"; and

21 (i) To be "responsible for underwriting [Cain Brothers'] principal risk position."

22 41. Within its proposal, Cain Brothers promised to act as the architect of the low cost and  
23 long term plan of refinancing, and proceeded to structure a multi-state, multi-facility group that  
24 consisted of RHF and its affiliates FPM, Bixby Knolls, Gold Country, Mayflower Health, Mayflower  
25 I, Sun City, Holly Hill, Merritt Island, Martin Luther, Yellowwood, Bluegrass (hereinafter, the "RHF  
26 Group") to re-fund existing debt through the issuance of approximately \$140 million in taxable and  
27 tax exempt municipal bonds. Both prior to and at the time the RHF Group accepted this proposed  
28 plan of refinancing, Cain Brothers sought to induce the RHF Group to accept and follow that plan

1 of refinancing by representing orally and in writing that structuring the RHF Group would increase  
2 its access to capital through future refinancing at a lower cost and would achieve an “appropriate”  
3 mix of fixed versus variable rate debt.

4 42. In or about August 1998, on behalf of itself and its affiliates that would be subject to  
5 the plan of refinancing, RHF formally accepted, in writing signed in its California headquarters, Cain  
6 Brothers’ proposal. A true and correct copy of the acceptance is attached hereto as Exhibit C.  
7 Exhibits A, B and C together, with various oral and written modifications, constituted a binding and  
8 enforceable refinancing agreement (“Financial Advisory Agreement”). The modifications included  
9 the above-described assumption of all obligations solely by Cain Brothers.

10 43. Pursuant to Plaintiffs’ and Cain Brothers’ express objectives under the Financial  
11 Advisory Agreement, Cain Brothers acted as Plaintiffs’ financial advisors and designed, structured,  
12 managed and implemented an extremely complex transaction involving bonds known as “SAVRS”  
13 and an interest rate swap, which Cain Brothers advised would benefit Plaintiffs in numerous ways  
14 and eliminate market risks.

15 44. Among other things, Cain Brothers made presentations to Plaintiffs regarding its  
16 refinancing plan, the SAVRS and associated swap contracts, and the associated insurance agreement  
17 at RHF’s Long Beach headquarters.

18 45. In addition to acting as a financial advisor, the Financial Advisory Agreement also  
19 proposed to Plaintiffs that Cain Brothers assume the additional role as principal underwriter. On or  
20 about December 7, 1998, after Cain Brothers had fully designed the structure, negotiated the swap  
21 transactions (described below), and advised Plaintiffs regarding the transaction, Cain Brothers also  
22 entered into a written Certificate Purchase Agreement with the RHF Group, pursuant to which Cain  
23 Brothers (and Banc One which later dropped out of the transaction) acted as “Underwriters,” and  
24 agreed to make an original bona fide public offering of certificates evidencing proportionate  
25 ownership interests in the right to receive installment payments “pursuant to the Official Statement,”  
26 a document prepared by Cain Brothers describing the offering and related arrangements. A true and  
27 correct copy of the Certificate Purchase Agreement is attached hereto as Exhibit D.

28 46. Among other things, the Certificate Purchase Agreement provided that Cain Brothers,

1 as an Underwriter, would “abide by all applicable rules of the Municipal Securities Rulemaking  
2 Board.” The Rules of the Municipal Securities Rulemaking Board state, among other things, that  
3 a financial advisor (i.e., Cain Brothers) owes the issuer of municipal securities (i.e. Plaintiffs) duties  
4 and “shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair  
5 practice.” MSRB R. G-17. Under the Rules, Cain Brothers, as underwriter providing financial  
6 advisory services, was required to, among other things, appropriately document and disclose the  
7 financial advisory relationship and compensation earned therefrom. MSRB R. G-23. Copies of the  
8 terms of MSRB Rules G-17 and G-23 are attached hereto as Exhibit E. As it turns out, Cain  
9 Brothers failed to comply with either of these rules.

10 **A. SAVRS**

11 47. Pursuant to Cain Brothers’ plan and at Cain Brothers’ recommendation, the entirety  
12 of the RHF Group’s bonds were issued as auction rate securities called Select Auction Variable Rate  
13 Securities, a product offered and marketed as “SAVRS” by Lehman Brothers.

14 48. Lehman Brothers was a global financial-services firm that, through its subsidiaries,  
15 provided services in investment banking, equity and fixed-income sales, research and trading,  
16 investment management, private equity, and private banking. At all times relevant, Lehman Brothers  
17 marketed itself as one of the leading investment banking firms, and that it was trustworthy, honest,  
18 stable, dependable, in compliance with all laws, well capitalized, and that its public financial  
19 statements, including but not limited to its balance sheet, were true and fair and accurately depicted  
20 its financial condition. The Individual Defendants knew that Lehman Brothers’ public financial  
21 statements, including its 10Ks and 10Qs and Annual Reports as well as the public comments by its  
22 senior officers, were carefully and regularly monitored by analysts, rating agencies, and other  
23 sophisticated experts on Wall Street, and that these analysts, rating agencies, and other sophisticated  
24 experts regularly reported, commented, or published their findings, summaries and/or opinions about  
25 Lehman Brother’s financial condition. The Individual Defendants also knew that the findings,  
26 comments, or opinions of these analysts, rating agencies, and other sophisticated experts affected  
27 both the value of Lehman Brothers’ publicly traded stock as well as the ability for Lehman Brothers  
28 to contract with and otherwise do business with third parties and/or counterparties who, as the

1 Individual Lehman Defendants knew, regularly relied on the accuracy of Lehman Brothers' financial  
2 statements either directly or through the findings, comments, or opinions of analysts, rating agencies  
3 and other sophisticated experts.

4 49. Lehman Brothers Holdings, Inc. owned and controlled its subsidiaries Lehman  
5 Brothers, Inc., Lehman Brothers Special Financing, Inc., and Lehman Government Securities, Inc.,  
6 entities which in one role or another all became involved with Plaintiffs' refinancing. Lehman  
7 Brothers Holdings, Inc., Lehman Brothers, Inc., Lehman Brothers Special Financing, Inc., and  
8 Lehman Government Securities, Inc. were alter egos of each other and shared a unity of interest, and  
9 it would sanction a fraud or promote an injustice not to treat them as alter egos. Further, these  
10 entities in actuality formed a single enterprise. Plaintiffs are informed and believe that these entities  
11 commingled funds and assets, used the same offices and employees, disregarded corporate  
12 formalities, and were used as mere shells or conduits for the affairs of each other.

13 50. SAVRS were supposed to bear interest at a variable rate that would be determined  
14 by a purportedly competitive bidding "Dutch" auction held by Lehman Brothers every 35 days that  
15 was supposed to provide a fair market interest rate. According to Cain Brothers, in each auction  
16 cycle, Lehman Brothers would solicit interest from existing bond holders and potential investors and  
17 collect bids from those bond holders and investors that specified a rate at which they would buy  
18 and/or sell the SAVRS. Lehman Brothers would then allegedly compile each bid and provide the  
19 raw data of each bid (and not the identity of the bidders) to a third party auction agent to determine  
20 the rate of the SAVRS. The auction rate was supposed to be set through a process in which bids with  
21 successively higher rates were accepted until all SAVRS available in the auction were sold. The  
22 highest bid at which SAVRS were sold in the auction, the so-called "winning bid" or "clearing rate,"  
23 would be the interest rate applicable for the next SAVRS period. Every 35 days, a new SAVRS  
24 auction would be held and new bids would be compiled by Lehman Brothers, from which the  
25 SAVRS rate would purportedly be reset at a clearing rate that represented a fair market rate. Lehman  
26 Brothers would continue to receive fees each auction cycle for orchestrating the auctions and  
27 compiling the bids to be submitted to the auction agent.

28 51. Cain Brothers' structure and plan provided that Lehman Brothers would be the only

1 market agent and broker-dealer with respect to the RHF Group's SAVRS, and that Lehman Brothers  
2 had total control over the auction process. Lehman Brothers provided the auction agent with the  
3 Maximum Rate – a high rate that would prevail only if there were a “failed” auction due to a lack  
4 of bids below the maximum rate. Lehman Brothers also provided the auction agent with all bid and  
5 sell orders. The auction agent would simply compile the information received from Lehman  
6 Brothers and pass that information, including the clearing rate, on to the RHF Group. Thus, Lehman  
7 Brothers could pre-determine what the clearing rate would be and, since it had sole control over the  
8 orders, was in the position to manipulate the auctions and convey the results of those auctions  
9 through the auction agent to the RHF Group. However, based on the representations and information  
10 received from Cain Brothers and Lehman Brothers and the contracts associated with the refinancing,  
11 the RHF Group justifiably believed that the auctions would be conducted fairly and properly without  
12 manipulation, and that fair market interest rates would be set.

13 52. According to representations, counsel and advice by Cain Brothers, the benefit of  
14 SAVRS to the RHF Group was that, among other things, they provided bond issuers the low cost  
15 and flexibility of variable rate debt. As long term securities with purportedly short term features,  
16 Cain Brothers represented in writing and orally to the RHF Group that SAVRS presented a safe  
17 alternative to more traditional and more expensive fixed rate bonds, provided a “time-tested  
18 structure” and “a large distribution market,” and did not require the RHF Group to maintain a  
19 liquidity facility. Cain Brothers also represented in writing, orally and without qualification that,  
20 under the structure more fully described below, the RHF Group had the option to convert the  
21 SAVRS into true fixed rate bonds at any time to lock in advantageous prevailing fixed rates.

22 **B. The 1998 Swap Contract**

23 53. Pursuant to the Financial Advisory Agreement and Cain Brothers' representations,  
24 counsel and advice, the SAVRS were issued in an “appropriate” mix of variable rate and  
25 “synthetically” fixed rate bonds, which Cain Brothers claimed would protect the RHF Group against  
26 the risk of variable interest rate fluctuations for 30 years. According to Cain Brothers' plan of  
27 refinancing, the interest rate of approximately 85% of the SAVRS would be synthetically fixed  
28 through an “interest rate swap,” another highly complicated, long-term, 30-year contract with

1 Lehman Brothers that Cain Brothers structured, negotiated and recommended (“the 1998 Swap”).  
2 A true and correct copy of the 1998 Swap is attached hereto as Exhibit F, in which several of the fees  
3 earned by Cain Brothers are described.

4 54. Pursuant to the 1998 Swap, in each successive auction cycle, the RHF Group agreed  
5 to pay a stipulated fixed rate of interest on the SAVRS to Lehman Brothers, and Lehman Brothers  
6 agreed to pay the holders of the SAVRS interest at the variable rate that it determined every 35 days  
7 by auction.

8 55. Pursuant to the 1998 Swap and consistent with its long term 30 year commitment,  
9 Lehman Brothers unconditionally guaranteed the RHF Group’s variable interest and capital payment  
10 obligations on the SAVRS that were subject to the agreement, and that such payments would be  
11 punctually made when they became due and payable.

12 56. Under the 1998 Swap, the RHF Group was also to make additional payments.  
13 Further, the RHF Group was to pay fees for Lehman Brothers’ services for auctioning the SAVRS  
14 every thirty-five days.

15 57. Among other things, Cain Brothers, as Plaintiffs’ agent and financial and strategic  
16 advisor and pursuant to its duties under the Financial Advisory Agreement, reviewed all swap related  
17 documentation, negotiated the language and structure of the swap transactions, including the ISDA  
18 Master Agreement, Schedule to the ISDA Master Agreement, Confirmations and Credit Support  
19 Annex, coordinated the implementation and closing of all swap transactions, and promised to  
20 monitor and provide all relevant documentation relating to the swap transactions, all for Plaintiffs’  
21 benefit and purportedly to ensure the cost efficiency and risk management of the plan of refinancing.

22 58. Both prior to and at the time the Financial Advisory Agreement and the 1998 Swap  
23 were executed, Cain Brothers and Lehman Brothers represented orally and in writing to the RHF  
24 Group that the benefit of the interest rate swap was that it permitted the RHF Group to “hedge,” or  
25 protect itself, against the risks of variable interest rate fluctuations and achieve a lower overall fixed  
26 rate than would be available if the SAVRS were issued as true fixed rate obligations. Cain Brothers  
27 also represented that the RHF Group could earn a windfall under the 1998 Swap, or be “in the  
28 money.”

1           59.     On behalf of Lehman Brothers, among other persons, Defendant O'Meara in 1998  
2 communicated directly with the RHF Group and its representatives regarding the SAVRS, the 1998  
3 Swap, and the overall transaction. O'Meara specifically spoke with counsel for the RHF Group,  
4 William Kelly, on August 4, 1998 and August 5, 1998.

5           60.     Lehman Brothers' strong financial condition and its public credit rating were  
6 absolutely material to and relied on by the RHF Group in entering into the 1998 Swap. The 1998  
7 Swap contained material written representations that Lehman Brothers' financial statements were  
8 true and correct and that Lehman Brothers was in no way in default or subject to any Termination  
9 Event. One Termination Event was if Lehman Brothers fell below a Moody's public rating of Baa3  
10 and an S&P rating of BBB-. The 1998 Swap further provided that Lehman Brothers would regularly  
11 provide its financial documents to the RHF Group throughout the thirty year term of the 1998 Swap,  
12 and Lehman Brothers specifically represented that those financial documents would be "true,  
13 accurate, and complete in every material respect." The 1998 Swap also provided that the Lehman  
14 Brothers Board of Directors had authorized "the execution and the delivery of" the 1998 Swap. Cain  
15 Brothers, as the RHF Group's swap adviser and monitoring agent, dealt directly and communicated  
16 with Lehman Brothers after the 1998 Swap was signed and regularly received information about  
17 Lehman Brothers' financial condition and advised the RHF Group about Lehman Brothers and the  
18 terms, obligations, and impact of the 1998 Swap.

19           61.     As Cain Brothers' plan of refinancing was structured, it was publicly reported in  
20 financial trade publications as the largest single bond deal ever sold to finance nursing homes. On  
21 Plaintiffs' information and belief, Fuld, O'Meara, Ainslie, Akers, Berlind, Cruikshank, Kaufman,  
22 and Macomber, who were employed and/or were serving as officers and directors of Lehman  
23 Brothers at the time, were well-informed of Lehman Brothers' activities and significant financial  
24 commitments and were knowledgeable and/or became aware through Lehman Brothers' Board  
25 authorization and/or through public reports of the issuance of the SAVRS (a Lehman Brothers  
26 product) and that the RHF Group was Lehman Brothers' counterparty under the 1998 Swap and  
27 related agreements.  
28

**C. Cain Brothers Recommends That The RHF Group Obtain ACA Bond Insurance**

62. To enhance the RHF Group's creditworthiness, the Financial Advisory Agreement and the 1998 Swap required that the RHF Group guarantee with a bond insurer the RHF Group's interest and capital payment obligations on the SAVRS.

63. Cain Brothers recommended that the RHF Group insure the SAVRS with ACA, which is a subsidiary of holding company ACA Capital Holdings, Inc., and a bond insurer founded in 1997 that purported to be the first domestic financial guaranty company to offer an "A" rated guaranty in the United States debt markets. Cain Brothers expressly promised and represented in the Financial Advisory Agreement to structure bonds "which work very well with an A rating." Cain Brothers further promised to use its expertise in vetting or otherwise investigating ACA (as well as investigating and evaluating any alternatives to ACA) and in negotiating the covenants and terms with ACA.

64. In 1998, Cain Brothers affirmatively represented and recommended in writing and orally that the transaction should be structured using ACA insurance, which would purportedly lower the RHF Group's credit enhancement costs significantly, and would provide a 30 year commitment, compared to a letter of credit, which Cain Brothers recommended against. Cain Brothers also represented in writing and orally that ACA would decrease the RHF Group's existing annual debt service requirements, and would increase the RHF Group's debt capacity, which would allow the RHF Group to expand. According to Cain Brothers, the credit enhancement provided by ACA was significantly better than any alternatives, which included the RHF Group pursuing its own public rating (at the time, the RHF Group had already obtained the minimum investment grade credit assessment from Standard & Poor's of BBB-).

65. Consistent with its representations regarding the low cost and the flexibility of the SAVRS, Cain Brothers represented to the RHF Group that ACA's bond insurance presented the best option to guarantee the SAVRS because ACA purportedly offered a safe, long term, investment grade rated commitment for a one time up-front fee.

66. Indeed, according to Joan Annett, a representative for Cain Brothers, RHF was sufficiently creditworthy to garner an investment grade rating on its own, but Cain Brothers



1 recommended a structure that, unbeknownst to Plaintiffs and insufficiently explained by Cain  
2 Brothers, was defective in numerous ways, including that Plaintiffs could not replace ACA or stand  
3 on their own credit, and was completely dependent on ACA's credit rating. Indeed, unbeknownst  
4 to the RHF Group and contrary to its representations, Cain Brothers did not properly vet or  
5 investigate ACA, nor did it perform adequate due diligence to find alternatives to ACA.

6         67. In or about December 1998, on the recommendation of Cain Brothers, the RHF Group  
7 and ACA entered into a written bond insurance agreement in which ACA would insure the SAVRS  
8 ("Insurance Agreement"). Under the Insurance Agreement, which RHF entered into in its Long  
9 Beach headquarters, the RHF Group paid a one-time, up-front premium of approximately \$3,000,000  
10 to ACA, who in exchange irrevocably and unconditionally agreed and represented that it would  
11 effectively "guarantee . . . payment when due of principal (whether at maturity or by mandatory  
12 sinking fund redemption) and interest on the 1998 SAVRS." Said guarantee by ACA was to be  
13 evidenced in the form of insurance policies and operated to maintain the investment strength of the  
14 bonds due to ACA's "A" rating. A true and correct copy of the Insurance Agreement is attached as  
15 Exhibit G. However said guarantee could only in fact be maintained as long as ACA maintained an  
16 investment grade rating. Without the benefit of ACA's investment grade rating, its guarantee was  
17 worthless and the SAVRS would fall to "junk" status.

18         68. The importance of ACA's obligation to maintain an investment grade rating for its  
19 promised guarantee to have value was acknowledged by ACA and stated in various documents  
20 associated with the Financial Advisory Agreement, including the Official Statement dated as of  
21 December 7, 1998 pertaining to the issuance of the SAVRS, and the Swap Contract, the terms of  
22 which both depended on ACA's investment grade rating. The guarantee based on the investment  
23 grade rating was the basic consideration that RHF was paying for.

24         69. ACA's obligations to guarantee the SAVRS and its acknowledgment of its need to  
25 maintain an investment grade rating in order for the guarantee to be effective were also expressed,  
26 amplified, interpreted and/or supplemented in the written 1998 Swap in Section 1(g)(ii) of the  
27 Schedule forming part of the 1998 Swap and also in the endorsement to the Interest Rate Swap  
28 Insurance Policy issued by ACA, with the RHF Obligated Group as "Obligor" and Lehman Brothers

1 as “Counterparty.” A true and correct copy of this Interest Rate Swap Policy is attached to this  
2 Complaint at Exhibit F (the Swap Contract), Exhibit G to Schedule to Master Agreement therein.  
3 The Interest Rate Swap Insurance Policy expressly referenced and was dependent on the terms of the  
4 Swap Contract. In confirmation of this requirement that for ACA’s guarantee to be effective, ACA  
5 had to maintain an investment grade rating, the 1998 Swap specifically identifies “a termination  
6 event” as ACA’s failure to maintain “[a] financial strength rating of at least BBB-.” See Ex. B to  
7 Complaint, Schedule to the Master Agreement, pg. 3. As ACA was aware, if did not maintain an  
8 investment grade rating (BBB- or better), the RHF Group would lose critical protections and suffer  
9 great financial harm, and ACA’s guarantee would be worthless.

10 70. Moreover, ACA further acknowledged its obligations by executing a written  
11 “Certificate of Bond Insurer as to Official Statement.” This Certificate expressly confirmed:

12 The statements contained in the Official Statement under the heading ‘SAVRS  
13 INSURANCE’, insofar as such statements constitute summaries of the matters  
14 referred to therein, accurately reflect and fairly present the information purported to  
be shown and, insofar as such statements describe ACA, fairly and accurately  
describe ACA.

15 In turn, the statements in the Official Statement under the SAVRS Insurance heading included the  
16 statement that ACA “is required to maintain contingency reserves on its liabilities in certain amounts  
17 and for certain periods of time.” ACA’s contingency reserves had a direct effect on its rating and  
18 its ability to maintain the promised guarantee.

19 71. Thus, both prior to and at the time the Insurance Agreement was executed in or about  
20 December 1998, Cain Brothers and ACA assured the RHF Group in writing that, consistent with its  
21 preferred investment grade “A” rating, ACA’s business practices were financially responsible in  
22 order to carefully limit its own risk exposure and maintain its “A” rating. For example, such  
23 representations were included, among other places, in promotional materials provided to the RHF  
24 Group by Cain Brothers and ACA that stated:

25 (a) “ACA believes that transactions bearing its guarantee should trade at market  
26 levels consistent with the company’s ‘A’ rating.”

27 (b) “ACA’s claims-paying resources are sound and are pledged to transactions  
28 which the company believes are ‘money good’ in their own right. By underwriting deals

1 with stable and improving credit characteristics and which have very low default  
2 expectations, the company is merely facilitating market access and efficiency, not ‘making  
3 bad deals good.’”

4 (c) “[ACA] would survive and meet its obligations beyond the third year of  
5 [‘Great Depression’ type] adverse economic conditions.”

6 (d) “ACA underwrites on the basis of insuring transactions which are expected  
7 to make full and timely repayment of principal and interest. Nevertheless, given the nature  
8 of its target markets, a minimal loss potential exists, and ACA will actively manage its  
9 insurance portfolio accordingly to mitigate the effect of any losses that may occur.”

10 (e) “ACA has established a 15% of earned premium loss reserve which is more  
11 than twice the industry average. This feature emphasizes the company’s financial  
12 conservatism and is supportive of a trading range consistent with its ‘A’ rating.”

13 (f) “Sector-specific underwriting policies and standards have been established  
14 and applied for every type of credit considered for ACA insurance. Such policies are  
15 intended to provide a basis for the avoidance of loss and will be applied in the context of a  
16 rigorous underwriting process which will consider all pertinent risk and credit factors.”

17 (g) “ACA manages the risks it insures by selectively choosing issuers, regardless  
18 of size, with favorable demographics that have demonstrated their commitment to meet their  
19 debt obligations and that utilize proceeds for essential purposes.”

20 72. Cain Brothers minimized any concerns about ACA and the possibility it would be  
21 downgraded with representations regarding the benefits of the entirety of the 1998 plan of  
22 refinancing, which included, among other things, the low risk stability offered by ACA insurance,  
23 the RHF Group’s right to terminate the 1998 Swap, and the potential windfall the RHF Group could  
24 earn, and be “in the money.”

25 73. Accordingly, prior to and at the time the Insurance Agreement was executed in or  
26 about December 1998, ACA and Cain Brothers continually represented in writing that ACA  
27 practiced financial conservatism, supported underwriting policies with very low default expectations,  
28 maintained a substantial capital reserve to cover potential losses, and diversified its very conservative

1 insurance portfolio to reduce its exposure to risk. According to ACA and Cain Brothers, the purpose  
2 of these policies was, among other things, to mitigate the financial effect of a catastrophic credit  
3 event, and continue to meet its contractual obligations under such adverse economic conditions.

4 **D. Cain Brothers' Post-Closing Support**

5 74. Pursuant to and consistent with the terms of the Financial Advisory Agreement, Cain  
6 promised substantial "post-closing" support to Plaintiffs, which included, among other things, acting  
7 as the RHF Group's swap adviser and monitoring agent and communicating with Lehman Brothers  
8 regarding the 1998 Swap; participating in the preparation of annual financial statements relating to  
9 the swap transactions; providing financial and strategic advice; monitoring and reporting to Plaintiffs  
10 regarding the performance, obligations, and potential risks of the swap transactions and ACA's bond  
11 insurance (including opportunities to restructure or enhance the performance of the plan of  
12 refinancing); and ensuring the continued cost efficiency and risk management of the overall plan of  
13 refinancing.

14 **E. Cain Brothers' Fees Pursuant To The Financial Advisory Agreement**

15 75. Cain Brothers earned substantial fees as financial advisors in connection with its  
16 several duties under the Financial Advisory Agreement. Under the Financial Advisory Agreement,  
17 Cain stated that, "in addition to fees charged for the underwriting of the bonds, . . . *Cain Brothers*  
18 *. . . earn[ed] fees for structuring, bidding and taking principal risk in the related swaps. The swap*  
19 *provider [Lehman] pays these fees directly to . . . Cain Brothers as co-agent[] in the transaction."*  
20 (emphasis in original). The Financial Advisory Agreement stated that, "[b]ecause of the complex  
21 nature of the swap transaction, it is difficult to estimate exactly what those fees should be," and Cain  
22 Brothers promised to disclose in writing all fees proposed by all bidders on the special products  
23 services both before and after payment of Cain Brothers' assumption of the principal risk, which  
24 would purportedly "allow[] RHF to determine the lowest effective rate from all bidders if no agent  
25 fees were charged and if no principal risk was taken, to determine if indirect costs to RHF are  
26 appropriate and appropriately scaled to value added." Cain Brothers also was to earn fees managing  
27 the investment and monetization of Plaintiffs' bond proceeds.

28 76. Cain Brothers' swap-related fees were also integrated into the 1998 Swap itself as

1 well as subsequent swap transactions with Lehman Brothers, so Plaintiffs did not pay those fees  
2 directly to Cain Brothers, but rather paid them to Lehman Brothers (who then paid Cain Brothers).  
3 Payments for negotiating, executing and delivering of the swap transactions on behalf of Plaintiffs  
4 was documented in, among other places, the various Confirmations of the 1998 Swap as well as  
5 other swap transactions with Lehman Brothers throughout the following years.

6 **F. The Issuance Of Additional Bonds**

7 77. In or about 1999, pursuant to the Financial Advisory Agreement and prior advice and  
8 recommendations, Cain Brothers underwrote additional fixed-rate bonds that were issued for the  
9 benefit of the RHF Group. At Cain Brothers' recommendation (upon which the RHF Group  
10 justifiably relied), ACA again served as the bond insurer for these bonds under the original Insurance  
11 Agreement. Again, Cain Brothers earned fees as the RHF Group's swap adviser.

12 78. In or about 2000, pursuant to the Financial Advisory Agreement and prior advice and  
13 recommendations, Cain Brothers underwrote additional fixed-rate bonds that were issued for the  
14 benefit of RHF affiliates St. Catherine and DeSmet. The RHF Group, whose creditworthiness was  
15 insured by ACA under the Insurance Agreement, guaranteed the bonds issued for the benefit of St.  
16 Catherine and DeSmet. Again, Cain Brothers earned fees as the RHF Group's swap adviser.

17 79. Notably, at about this time, Cain Brothers officially formed a "strategic partnership"  
18 with Lehman Brothers, where Lehman Brothers agreed to buy a 14 percent stake in Cain Brothers.  
19 This "strategic partnership" was not disclosed to Plaintiffs.

20 **III. The Failure Of Cain Brothers' Plan Of Refinancing**

21 80. The RHF Group's plan of refinancing that Cain Brothers recommended, advised, and  
22 implemented was not safe, low risk, low cost, or flexible as Cain Brothers had claimed.  
23 Significantly, even though the RHF Group's creditworthiness was purportedly a concern at the time  
24 the 1998 plan of refinancing was proposed and implemented, it was the guarantees provided by  
25 Lehman Brothers and ACA that were highly risky and that became worthless, and the transaction  
26 structure imposed substantial detriments against the RHF Group.

27 **A. The Undisclosed and Unfair Valuations of the Swap Contract**

28 81. Unbeknownst to the RHF Group, the 1998 Swap was valued by Lehman Brothers

1 pursuant to a secret, restrictive valuation methodology developed by Lehman Brothers that  
2 effectively prevented the RHF Group from being “in the money” despite the fact that the SAVRS’  
3 variable rate determined at auction often exceeded the synthetic “fixed” rate.

4 82. In addition, on Plaintiffs’ information and belief and unbeknownst to the RHF Group,  
5 Lehman Brothers was involved in an illegal price fixing and/or bid rigging scheme in which it  
6 manipulated the SAVRS’ rates determined at auction to its own benefit. On Plaintiffs’ information  
7 and belief, Lehman Brothers would pre-select a “winning bid” during each auction cycle to ensure  
8 that the SAVRS would trade at below fair market value and maximize their profits and inflate the  
9 amount the RHF Group was “out of the money” under the Swap Contract. On Plaintiffs’ information  
10 and belief, executives at Lehman Brothers had knowledge of, directed, approved, and/or ratified  
11 Lehman Brothers’ practice and policies of bid rigging securities auctions and otherwise inflating the  
12 amount Lehman Brothers was “in the money” under the Swap Contract.

13 83. Because of Cain’s negligence and breaches of fiduciary duty in advising and  
14 structuring the transaction and through Lehman Brothers’ aforementioned continuing bad faith and  
15 corrupt conduct in manipulating the auctions, the RHF Group was always “out of the money” on the  
16 1998 Swap in an unreasonably and unfairly excessive amount. The RHF Group was unaware that  
17 the 1998 Swap was valued by Lehman Brothers pursuant to a secret, restrictive valuation  
18 methodology, and did not understand that the calculations on the 1998 Swap may have been inflated  
19 in Lehman Brothers’ favor or that Lehman Brothers was unfairly keeping the RHF Group “out of the  
20 money.” Therefore, the RHF Group continued to pay amounts allegedly owing per the SAVRS and  
21 the 1998 Swap.

22 84. Cain Brothers had a continuing duty to “support” the RHF Group and monitor  
23 Lehman Brothers, including a duty to disclose and advise the RHF Group of all material facts  
24 regarding Lehman Brothers and the 1998 plan of refinancing, including, among other things,  
25 information relating to the interest rate swaps and the bidders’ proposed rates on the swaps. Cain  
26 Brothers knew or should have known through the exercise of reasonable diligence that, among other  
27 things, the way Cain Brothers had advised and structured the transaction resulted in Lehman  
28 Brothers’ unfair valuation methodology, as well as Lehman’s price fixing or bid rigging conspiracy

1 and wrongful acts in connection with the auctions. Cain Brothers failed to disclose these facts to the  
2 RHF Group or otherwise properly advise or counsel the RHF Group. In fact, Cain Brothers had a  
3 close relationship with Lehman Brothers, and ultimately Lehman Brothers became a substantial  
4 financial investor in Cain Brothers.

5 **B. ACA's Mismanagement And Exposure To Risky Subprime Mortgage-Backed**  
6 **Securities**

7 85. In or about 2003 through 2007, in reckless pursuit of higher profits, and despite its  
8 obligations to guarantee Plaintiffs' capital and interest repayments on the SAVRS and to maintain  
9 its "A" rating, and contrary to its promises of financial conservatism and responsibility, ACA  
10 guaranteed securities backed by high risk loans, including, among other things, subprime housing  
11 mortgages, well in excess of its ability to do so.

12 86. In or about 2005, despite its exposure to the subprime housing market, ACA  
13 reaffirmed in writing that its business practices continued to be financially responsible, and that it  
14 maintained sufficient equity and loss reserves in line with its preferred investment grade "A" rating.  
15 Specifically, in its 2005 quarterly financial reports, ACA represented that:

16 (a) "[ACA] reported [a] net income of \$14.7 million for the first quarter of 2005  
17 . . . related to positive mark to market gains on derivatives, as well as continued growth in  
18 our structured finance businesses."

19 (b) "ACA reported a net operating income for the first quarter of 2005 of \$8.2  
20 million, an increase of 162% over the first quarter of 2004."

21 (c) "[M]anagment [is] confident that we are still on plan for the full year."

22 (d) "We believe the unaudited financial information we are making available  
23 demonstrates [ACA's] renewed capital position, profitability and growth."

24 87. Furthermore, in or about May 2005, when RHF was considering re-structuring its  
25 debt, Ruben Selles (the executive vice president) and Edward Gilpin (the CFO) of ACA represented  
26 to Brian Magnone (vice president) of RHF that ACA was financially stable and thus would not be  
27 downgraded.

28 88. However, contrary to its promises and representations, due to its irresponsible

1 investment policies and underwriting practices, ACA's risk exposure in or about 2005 through 2007  
2 was massive. In or about 2007, ACA's stock price dropped 95 percent, which wiped out its equity  
3 and resulted in a negative net worth. In or about November 2007, in response to reports that it would  
4 be downgraded from its investment grade "A" rating, ACA stated that it would need to raise  
5 additional capital to comply with its guaranty obligations. However, ACA irresponsibly and  
6 negligently maintained extremely inadequate loss reserves, and was billions of dollars short of what  
7 was needed to pay potential claims and cover its continuing losses. On or about December 19, 2007,  
8 the credit rating agency Standard & Poor's downgraded ACA's credit rating from "A" to "CCC,"  
9 or junk status. It was during this time that Plaintiffs discovered that ACA's prior representations,  
10 including that it conducted itself in a responsible manner and was financially strong, were in fact  
11 false.

12 89. Due to the downgrade, ACA was no longer able to adequately guarantee Plaintiffs'  
13 capital and interest payment obligations, resulting in a series of extremely negative consequences  
14 for Plaintiffs.

15 90. On Plaintiffs' information and belief, Cain Brothers, which had a continuing duty to  
16 "support" Plaintiffs, including a duty to disclose and advise the RHF Group of all material facts  
17 regarding the 1998 plan of refinancing, and which continued to advise the RHF Group up through  
18 and following ACA's downgrade, knew or should have known through the exercise of reasonable  
19 diligence about the extent of ACA's risky, negligent and irresponsible business practices and the  
20 substantial risks presented by ACA's failure, and failed to properly disclose, advise or warn the RHF  
21 Group.

22 **C. Lehman Brothers Admits Manipulating Auctions and Is Ordered by The SEC**  
23 **To Cease and Desist, But Defendant Fuld Has Lehman Continue Violative**  
24 **Practices**

25 91. On May 31, 2006, the United States Securities and Exchange Commission ("S.E.C.")  
26 issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and  
27 Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities  
28 Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934 (the "S.E.C. Order").



1           92.     The S.E.C. Order found that Lehman Brothers (and other broker-dealers) committed  
2 numerous Section 17(a)(2) Securities Act violations with respect to auction rate securities, including  
3 the following “violative practices”:

4           (a)     Allowing “open bids” and/or “market bids” in auctions, in which the bidder  
5 indicated that it would buy at whatever rate was set during an auction. This  
6 practice inflated the clearing rate.

7           (b)     Submitting bids or asking investors to change bids so that the auctions  
8 cleared at different rates than they otherwise would have.

9           (c)     Submitting bids or asking investors to submit bids to prevent the “all-hold  
10 rate,” which is a below-market rate set when all current holders want to hold  
11 their positions so that there are no securities for sale in the auction.

12           (d)     Submitting or revising bids after submission deadlines, which affected the  
13 clearing rate.

14           (e)     Engaging in “price talk” which encouraged bidders to bid only at certain  
15 rates, thereby affecting the clearing rate.

16           93.     Lehman Brothers was censured and fined \$1.5 million by the S.E.C. and was ordered  
17 to cease and desist from committing Section 17(a)(2) violations. Further, Lehman Brothers was  
18 ordered to provide all holders of its auction rate securities and the issuers of such securities with a  
19 written description of its material auction practices and procedures. Moreover, Lehman Brothers was  
20 required to certify in writing, through either its chief executive officer or general counsel, that it had  
21 implemented procedures reasonably designed to prevent and detect failures to conduct the auction  
22 process in accordance with disclosed auction procedures.

23           94.     At the time of the SEC Order, Defendant Fuld was the chief executive officer of  
24 Lehman Brothers and Defendant O’Meara was CFO of Lehman Brothers. Defendants Fuld,  
25 O’Meara and Callan, as high level executives of Lehman Brothers, had responsibility for, among  
26 other things, monitoring public pronouncements about Lehman Brothers that might impact Lehman  
27 Brothers in a significant manner and otherwise assuring that Lehman was conducting itself properly.  
28 Defendants Fuld, O’Meara and Callan all knew of the SEC order at the time it was announced. The

1 SEC order was summarized on the SEC website and the subject of an SEC press release. The SEC  
2 Order was also reported in several trade publications and financial media sources. Defendants Fuld,  
3 O'Meara and Callan regularly reviewed trade publications or financial media regarding anything  
4 published about Lehman Brothers. Moreover, pursuant to the SEC Order, Fuld was specifically  
5 charged with the obligation either to personally certify or to instruct his general counsel to "certify  
6 in writing to the staff of the Commission that [Lehman Brothers] has implemented procedures that  
7 are reasonably designed to prevent and detect failures by [Lehman Brothers] to conduct the auction  
8 process in accordance with the auction procedures disclosed in the disclosure documents and any  
9 supplemental disclosures and that [Lehman Brothers] is in compliance with Section IV.E. of this  
10 Order." Section IV.E. of the SEC order required providing information to customers and issuers,  
11 including Plaintiffs.

12 95. Although Plaintiffs were issuers of SAVRS and necessarily had been and would  
13 continue to be affected by Lehman Brothers' auction practices and procedures, Defendant Fuld never  
14 had Lehman Brothers inform Plaintiffs of the S.E.C. Order or provide Plaintiffs with the S.E.C.-  
15 ordered written description of its material auction practices and procedures, despite his knowledge  
16 thereof and the requirement that he (or the general counsel pursuant to his direction) certify to the  
17 SEC that he had done so. Thus, Lehman Brothers and Fuld directly violated the SEC order by this  
18 failure to inform Plaintiffs even though Fuld either personally certified he had done so to the SEC  
19 or directed the general counsel to so certify. Cain Brothers also failed to warn or otherwise inform  
20 Plaintiffs about these practices by Lehman Brothers.

21 96. Rather, Plaintiffs are informed and believe and thereon allege that Defendants Fuld,  
22 O'Meara and Callan decided to ignore the SEC Order and continue to commit the "violative  
23 practices" described in the SEC Order in spite of the fact that Lehman Brothers had been ordered  
24 both to cease and desist such practices and that Lehman Brothers had been ordered to disclose such  
25 practices. Plaintiffs further are informed and believe and thereon allege that Defendants Fuld,  
26 O'Meara and Callan deemed the SEC fines as small and insignificant in comparison to the huge fees  
27 Lehman Brothers was earning through its violative practices and concluded that the fine was a cost  
28 of doing a lucrative business, and thus they decided to ignore the SEC Order to stop violative

1 practices or to send information to Plaintiffs disclosing those practices; rather, Lehman Brothers paid  
2 the fine (which was authorized by Fuld and O'Meara) and Fuld instructed that the improper practices  
3 be continued at Lehman Brothers. Indeed, trade publications reported in 2007 that despite the SEC  
4 Order, Lehman Brothers (and others) continued to "manipulate investor purchases" of auction rate  
5 securities and that the auctions conducted "[bore] little resemblance to a pure Dutch auction process"  
6 and "shouldn't be called auctions because of the dealer's [like Lehman Brothers] ability to set rates."  
7 In fact, it was widely reported in 2008 when the auction rate securities market deteriorated that  
8 broker dealers, including Lehman Brothers, had continued to manipulate auctions on auction rate  
9 securities like the SAVRS.

10 **D. RHF Loses the Protection of the 1998 Swap Agreement, and Its Payment**  
11 **Obligations for the SAVRS Skyrocket as Lehman Brothers Manipulates the**  
12 **Auctions.**

13 97. Thereafter, around the time of ACA's downgrade to junk status on or about December  
14 19, 2007, Lehman Brothers took the position that the 1998 Swap had entered an "alternative floating  
15 rate" – an amount based on an index rate significantly below the SAVRS rates – an unusual  
16 provision that was never fully or properly explained by Cain Brothers in negotiating, executing or  
17 delivering the swap transactions on Plaintiffs' behalf, particularly that Plaintiffs were unable to cure  
18 ACA's downgrade under the terms of the 1998 Swap Contract, and was a terrible provision for  
19 Plaintiffs in that it took away any protections or benefits provided under the 1998 Swap. Under the  
20 regular operating terms of the 1998 Swap, the RHF Group's monthly interest payments were fixed  
21 at 5.19% for tax-exempt bonds, while Lehman Brothers was responsible for paying the SAVRS  
22 rates. When the "alternative floating rate" was triggered, however, the RHF Group was still required  
23 to pay the regular fixed rates to Lehman Brothers, but Lehman Brothers was no longer required to  
24 pay the SAVRS rates; instead, it only needed to pay the "alternative floating rate," and Plaintiffs  
25 were required to make up all of the shortfall on the SAVRS. Thus, under this "alternative floating  
26 rate," the RHF Group was required to continue paying Lehman Brothers the same fixed rate, but any  
27 protection that the RHF Group had received through the 1998 Swap was all but eliminated and  
28 instead the RHF Group had the burden of paying whatever SAVRS rate Lehman Brothers dictated.

1           98.     Despite Cain Brothers' prior representations that the refinancing plan it had structured  
2 and designed was safe and beneficial, after the 1998 Swap entered the "alternative floating rate,"  
3 Plaintiffs had no means of curing this disastrous situation.

4           99.     Compounding matters, Lehman Brothers continued to control the SAVRS auctions,  
5 and, due to the switch to the "alternative floating rate" on the 1998 Swap, it now had no obligation  
6 to pay the SAVRS rates, and so could profit by manipulating the SAVRS rates upward using  
7 methods including those prohibited by the S.E.C. in its 2006 Order. In fact, Plaintiffs are informed  
8 and believe this is what Lehman Brothers did.

9           100.    Since Lehman Brothers no longer had to pay the SAVRS rates, virtually overnight,  
10 the RHF Group's SAVRS rates skyrocketed. Over the previous four years, when Lehman Brothers  
11 was obligated to pay the SAVRS rates (but also controlled them), the SAVRS rates had rarely  
12 exceeded 5% and did not approach the applicable maximum rate. But, Plaintiffs are informed and  
13 believe, beginning in December 2007, Lehman Brothers manipulated the SAVRS rates – almost all  
14 of which the RHF Group was now required to pay due to the triggered "alternative floating rate" –  
15 up to very high rates just barely below the maximum rates, outstripping the previous rates by  
16 extraordinary amounts, even though the RHF Group had an unblemished history of making all its  
17 payments on the SAVRS.

18           101.    Through its conduit, the auction agent, and/or directly, Lehman Brothers made the  
19 following representations to RHF in its Long Beach headquarters:

20           a.     On or about December 11, 2007, RHF was informed in writing by the auction  
21 agent, the Bank of New York Trust Company, that the clearing rate for most  
22 of that auction period's SAVRS was 15.500%, compared to the applicable  
23 Maximum Rate of 15.611%. On or about January 3, 2008, RHF was  
24 informed in writing that funds in the amount of \$605,002.30 would be  
25 required by January 7, 2008 for the January 16, 2008 debt service payments.  
26 RHF thereafter wired this amount on or about January 7, 2008.

27           b.     On or about January 7, 2008, Seth Konheim, a Vice President at Lehman  
28 Brothers, sent an email on behalf of Lehman Brothers to RHF stating that an

1 additional \$874,007.74 was due to Lehman Brothers with respect to that  
2 auction period. RHF thereafter wired this amount on or about January 9,  
3 2008.

4 c. On or about January 15, 2008, RHF was informed in writing by the auction  
5 agent, the Bank of New York Trust Company, that the clearing rate for most  
6 of that auction period's SAVRS was 12.000%, compared to the applicable  
7 Maximum Rate of 12.068%. On or about February 8, 2008, RHF was  
8 informed in writing that funds in the amount of \$1,754,638.79 would be  
9 required by February 11, 2008 for the February 20, 2008 debt service  
10 payments. RHF thereafter wired this amount on or about February 11, 2008.

11 d. On or about February 19, 2008, RHF was informed in writing by the auction  
12 agent, the Bank of New York Trust Company, that the clearing rate for most  
13 of that auction period's SAVRS was 9.300%, compared to the applicable  
14 Maximum Rate of 9.332%. On or about March 14, 2008, RHF was informed  
15 in writing that funds in the amount of \$1,457,491.54 would be required by  
16 March 17, 2008 for the March 26, 2008 debt service payments. RHF  
17 thereafter wired this amount on or about March 17, 2008.

18 e. On or about March 25, 2008, RHF was informed in writing by the auction  
19 agent, the Bank of New York Trust Company, that the clearing rate for most  
20 of that auction period's SAVRS was 7.950%, compared to the applicable  
21 Maximum Rate of 7.961%. On or about April 21, 2008, RHF was informed  
22 in writing that funds in the amount of \$1,355,811.68 would be required by  
23 April 21, 2008 for the April 30, 2008 debt service payments. RHF thereafter  
24 wired this amount on or about April 21, 2008.

25 f. On or about April 29, 2008, RHF was informed in writing by the auction  
26 agent, the Bank of New York Trust Company, that the clearing rate for most  
27 of that auction period's SAVRS was 8.480%, compared to the applicable  
28 Maximum Rate of 8.483%. On or about May 23, 2008, RHF was informed

1 in writing that funds in the amount of \$1,406,837.95 would be required by  
2 May 27, 2008 for the June 4, 2008 debt service payments. RHF thereafter  
3 wired this amount on or about May 27, 2008.

4 g. On or about June 3, 2008, RHF was informed in writing by the auction agent,  
5 the Bank of New York Trust Company, that the clearing rate for most of that  
6 auction period's SAVRS was 7.350%, compared to the applicable Maximum  
7 Rate of 7.354%. On or about June 27, 2008, RHF was informed in writing  
8 that funds in the amount of \$970,161.14 would be required by June 30, 2008  
9 for the July 7, 2008 debt service payments. RHF thereafter wired this amount  
10 on or about June 30, 2008.

11 102. Plaintiffs are informed and believe and on that basis allege that these foregoing results  
12 – though presented as being obtained through the proper auction process – actually were not obtained  
13 through a fair and proper auction process as promised and represented by Lehman Brothers. Instead,  
14 Lehman Brothers intentionally drove up the rates through manipulation, including through the  
15 techniques described in the S.E.C. Order, but concealed from Plaintiffs that they were doing so.  
16 Lehman Brothers continued to claim that the rates were obtained through the regular auction process,  
17 when actually the rates were obtained through a materially changed, unfair process by which Lehman  
18 Brothers set the auction rates just barely below the applicable maximum rates – much higher than  
19 they would have been under proper auction procedures. This wrongful and unfair conduct was  
20 evidenced by, among other things, the fact when the alternative floating rate was triggered and  
21 Lehman Brothers was no longer required to pay the SAVRS rates under the Swap Contract, the rates  
22 for the SAVRS suddenly jumped to rates much higher than previous rates. Moreover,  
23 pre-“alternative floating rate” SAVRS rates did not approach the applicable maximum rates,  
24 generally remaining many full percentage points below the applicable maximum rates. But upon  
25 imposition of the “alternative floating rate,” the SAVRS rates were consistently set at a level just  
26 barely below – by hundredths or even thousands of percentage points – the applicable maximum  
27 rates. These results could not have occurred under a competitive, fair and unmanipulated auction  
28 process.

103. By intentionally manipulating the auctions to achieve SAVRS rates just barely below the maximum rates, Lehman Brothers could and, Plaintiffs are informed and believe, did maximize its profits by purchasing or holding SAVRS that paid exorbitantly high rates, even though (as Lehman Brothers knew) the Plaintiff issuers had never missed a payment on the SAVRS, they continued to be financially strong, and their viability and financial strength was not jeopardized by the downgrade of ACA (even though the downgrade ended up causing Plaintiffs substantial harm). Rather than setting or approximating a market rate, the auctions resulted in Plaintiffs paying grossly inflated rates that did not reflect their financial situation or the market conditions as a whole.

104. By virtue of its control of the Cain Brothers designed auction process, including how much the RHF Group supposedly owed on the SAVRS, Lehman Brothers had sole knowledge of the mechanics and purported results of the auctions. Plaintiffs, meanwhile, were in a severely compromised, dependent position and could only rely on Lehman Brothers' representations. Thus, Plaintiffs had no choice but to accede to the demands for payment, so as not to default with respect to the Swap Contract or the SAVRS.

**E. The RHF Group Refinances The SAVRS And Converts Them To Variable Rate Demand Bonds**

105. In or about December 2007 and January 2008, following ACA's downgrade, and because of the suddenly immense payments under the 1998 Swap and SAVRS and their inability to "cure" the problems arising from ACA's downgrade, in order to mitigate its losses and avoid potential financial disaster, the RHF Group was forced to begin to seek to restructure the transaction and re-fund the SAVRS and secure them with letters of credit from banks rather than a bond insurer.

106. However, in or about the Spring of 2008, Lehman Brothers was claiming that the RHF Group was purportedly "out of the money" on the 1998 Swap, so that terminating it would cost the RHF Group in excess of \$13 million. At the time, Lehman Brothers was viewed as a leader in the financial markets and continued to promote itself as financially stable and adequately capitalized, and therefore contended that its valuation was true, correct and honorable. However, Lehman Brothers' valuation was in fact biased and unfair. Because of the design of the original plan of refinancing by Cain Brothers and the acts of all Defendants, the RHF Group was under duress and

1 in a disadvantageous position. Lehman Brothers would not agree to amend the Swap Contract but  
2 insisted on a new, more burdensome swap agreement. Thus, the RHF Group, St. Catherine and  
3 DeSmet were then forced by Lehman Brothers to terminate the 1998 Swap and enter into a new,  
4 different, disadvantageous 20-year term swap agreement with Lehman Brothers in connection with  
5 the soon to be refinanced bonds (“the 2008 Swap”). These agreements were also entered into by the  
6 RHF Group in California. A true and correct copy of the 2008 Swap is attached hereto as Exhibit  
7 H.

8 107. Pursuant to the 2008 Swap, among other things, Lehman Brothers required that  
9 Plaintiffs agree to pay a much higher synthetic “fixed” interest rate to avoid immediately paying the  
10 alleged \$13 million to compensate Lehman Brothers for the purported value of the 1998 Swap at the  
11 time of renegotiation. Under the 2008 Swap, in or about July 2008, Lehman Brothers promised to  
12 guarantee Plaintiffs’ variable interest and capital payment obligations on the new variable rate bonds  
13 that were subject to the agreement, reaffirmed that such payments would be punctually made when  
14 they became due and payable, and represented that Lehman Brothers was adequately capitalized and  
15 had accurately and fairly publicly reported its financial condition and could continue to perform its  
16 obligations over the 20 year term of the contract.

17 108. Cain Brothers, which had a continuing duty of support, including a duty to disclose  
18 and advise Plaintiffs of all material facts regarding the RHF Group’s 1998 plan of refinancing and  
19 the additional bonds issued for the benefit of St. Catherine and DeSmet, knew or should have known  
20 through the exercise of reasonable diligence about, among other things, (1) the hidden costs and risks  
21 of SAVRS; (2) Lehman Brothers’ unfair Swap valuation methodology; (3) Lehman Brothers’ unfair  
22 SAVRS auction practices; (4) the defective nature of the 1998 plan of refinancing and the Swap  
23 Contract, including, among other things, the RHF Group’s inability to be anything but “out of the  
24 money” under the Swap Contract; (5) the RHF Group’s inability to cure the effects of ACA’s  
25 downgrade; and (5) the RHF Group’s inability to exit the “alternative floating rate” under the Swap  
26 Contract and Lehman Brothers’ concurrent ability to manipulate the SAVRS auctions to its benefit  
27 and the RHF Group’s detriment. Cain Brothers structured a flawed transaction and failed to  
28 adequately disclose or warn of any of this information to Plaintiffs, and instead continually



1 represented that the 1998 plan of refinancing presented a safe alternative to more traditional and  
2 more expensive fixed rate bonds and would decrease the cost of any future refinancing by Plaintiffs.

3 **IV. Lehman Brothers' Own Mismanagement And Exposure To Risky Subprime**  
4 **Mortgage-Backed Securities**

5 109. In or about July 2008, Plaintiffs completed the refinancing of the SAVRS and  
6 converted them to Variable Rate Demand Bonds, which were not auction rate securities and were  
7 secured with letters of credit from banks rather than a bond insurer.

8 110. Pursuant to the Master Agreement of the 2008 Swap, Lehman Brothers made a series  
9 of representations with respect to its ability to perform thereunder. For instance, under Section 2(a)  
10 of the Master Agreement of the 2008 Swap, entitled "Obligations - General Conditions," Lehman  
11 Brothers represented that, as of July 2008, it was solvent and able to perform its obligations:

12 Each party will make each payment or delivery specified in each Confirmation to be  
13 made by it, subject to the other provisions of this Agreement . . . (iii) Each obligation  
14 of each party under Section 2(a)(i) is subject to (1) the condition precedent that no  
Event of Default or Potential Event of Default with respect to the other party has  
occurred and is continuing.

15 111. Lehman Brothers reaffirmed its purported ability to perform under Section 3(a) of the  
16 Master Agreement of the 2008 Swap, entitled "Representations," which provided that "each party  
17 represents to the other party (which representations will be deemed to be repeated by each party on  
18 each date on which a Transaction is entered into ...)" that:

19 ***Powers.*** It [the party] has the power to execute this Agreement and any other  
20 documentation relating to this Agreement to which it is a party, to deliver this  
21 Agreement and any other documentation relating to this Agreement that it is required  
22 by this Agreement to deliver and to perform its obligations under this Agreement and  
any obligations it has under any Credit Support Document to which it is a party and  
has taken all necessary action to authorise such execution, delivery and performance  
...

23 ***Obligations Binding.*** Its obligations under this Agreement and any Credit Support  
24 Document to which it is a party constitute its legal, valid and binding obligations,  
enforceable in accordance with their respective terms . . .

25 112. By entering into the 2008 Swap, each party also represented an absence of certain  
26 events, including "[n]o event of Default or Potential Event of Default or, to its knowledge,  
27 Termination Event with respect to it has occurred and is continuing and no such event or  
28 circumstance would occur as a result of its entering into or performing its obligations under this

1 Agreement or any Credit Support Document to which it is a party.” See Exhibit H, § 3(b)-(c).  
2 “Events of default” and “potential events of default” included “failure by the party to make, when  
3 due, any payment under this Agreement,” breach of the agreement by “failure by the party to comply  
4 with or perform any agreement or obligation,” “representation[s] . . . [that were] incorrect or  
5 misleading in any material respect when made” and when any party “becomes insolvent . . . [or]  
6 institutes . . . a proceeding seeking a judgment of insolvency or bankruptcy.”

7 113. However, despite making an unconditional guarantee of Plaintiffs’ variable interest  
8 and capital payment obligations on the new bonds in or about July 2008 and affirmatively  
9 representing, both in the 2008 Swap and financial statements disclosed to Plaintiffs, that it was a  
10 strong, viable and adequately capitalized company capable of performing its obligations under the  
11 2008 Swap, a contract that was supposed to provide 20 years of protection and stability to Plaintiffs,  
12 Lehman Brothers failed to disclose that *it was not solvent*. Rather, Lehman Brothers was suffering  
13 from unprecedented losses due to, among other things, its investments in subprime mortgage backed  
14 securities, real estate, and related investments that doomed the continued existence of the company.  
15 Indeed, a mere two months after the completion of Plaintiffs’ refinancing of the SAVRS and the  
16 signing of the 2008 Swap in July 2008, Lehman Brothers sought Chapter 11 protection in the largest  
17 bankruptcy ever filed.

18 **A. The Individual Lehman Defendants Were Each Extremely Sophisticated and**  
19 **Sought To Maintain the False Impression that Lehman Brothers Was**  
20 **Financially Strong**

21 114. Lehman Brothers’ collapse resulted from significant failures and omissions in its  
22 corporate governance, where senior management – including Defendants Fuld, O’Meara, and Callan  
23 – engaged in actionable balance sheet manipulation and public misrepresentations of the company’s  
24 financial condition that they knew would be relied upon by counterparties (including Plaintiffs) to  
25 long-term agreements such as interest rate swaps.

26 115. **Fuld** was employed by Lehman Brothers since 1969, and served as a member of the  
27 Board of Directors of Lehman Brothers from 1990 to 2008, as Lehman Brothers’ Chief Executive  
28 Officer from 1993 to 2008, and as Chairman of the Board of Directors from 1994 to 2008. Fuld was

1 also a member of the Executive Committee, which had the authority, in the intervals between  
2 meetings of the Board of Directors, to exercise all the authority of the Board of Directors that are not  
3 reserved for the full Board of Directors under Delaware General Corporation Law or Lehman  
4 Brothers' Restated Certificate of Incorporation. Fuld was also a substantial stockholder in Lehman  
5 Brothers. Fuld was at all times extremely knowledgeable, sophisticated, and well-informed of all  
6 of Lehman Brothers' financial condition, investments and activities, including the 1998 plan of  
7 refinancing involving Plaintiffs and the 2006 S.E.C. Order. Fuld authorized, approved, directed  
8 and/or ratified the company to embark upon an aggressive growth strategy and commit its own  
9 capital in commercial real estate, leveraged lending, and private equity-like investments, which  
10 included the origination of subprime and other non-prime mortgages. In early 2007, at a time when  
11 Fuld knew that other participants in the subprime mortgage industry were going out of business or  
12 cutting back operations, he instead authorized the company to continue to grow its residential  
13 mortgage origination business and commercial real estate portfolio. However, in late 2007 and 2008,  
14 when the subprime mortgage crisis worsened, Lehman Brothers was burdened with a vast amount  
15 of assets that it could not sell and was suffering unprecedented losses. In order to project a  
16 completely false and fictional picture of Lehman Brothers' solvency and thereby maintain investor  
17 and counterparty confidence and protect his own financial interests, Fuld authorized Lehman  
18 Brothers to manipulate its financial statements, including significantly increasing its undisclosed use  
19 of off-balance sheet devices, known internally as "Repo 105" and "Repo 108" (collectively "Repo  
20 105") transactions, which temporarily removed securities inventory from its balance sheet to  
21 intentionally conceal the fact that Lehman Brothers was over-leveraged and over-exposed to toxic  
22 subprime mortgage backed securities and/or other real estate-related investments and that its risk  
23 exposure in the event of a collapse of the housing market was massive. At the same time, Fuld  
24 falsely reported publicly favorable net leverage numbers and represented that Lehman Brothers had  
25 "never been stronger," particularly after fellow investment banking giant Bear Stearns failed under  
26 the weight of its own subprime mortgage investments. Fuld knew that Lehman Brothers' public  
27 rating was based on review of its financial statements, particularly its balance sheet, and intended  
28 to provide this false information so that Lehman Brothers would not lose its high public rating. Fuld

1 knew that Lehman Brothers had numerous transactions like the 2008 Swap which required that  
2 Lehman Brothers maintain its public rating above a certain level to avoid negative consequences to  
3 Lehman Brothers, and so he sought to avoid those negative consequences by presenting false public  
4 financial information (including an inaccurate balance sheet) to the rating agencies and “the Street”  
5 (i.e., analysts, investors and experts on Wall Street).

6       116. **O’Meara**, like Fuld, was also a long-time Lehman Brothers’ employee, and was one  
7 of the RHF Group’s contacts at the company during the implementation of the 1998 plan of  
8 refinancing and afterwards, and clearly knew about the RHF Group, the 1998 plan of refinancing and  
9 related transactions, as well as the 2006 S.E.C. Order. O’Meara served as Lehman Brothers’ CFO  
10 and Controller from 2004 through November 2007, and from December 2007 to September 2008  
11 served as the company’s Chief Risk Officer. O’Meara had express and extensive knowledge of  
12 Lehman Brothers’ financial condition, particularly from 2004 to 2008, and knew that Lehman  
13 Brothers’ 2007 and 2008 financial statements materially misrepresented its deteriorating financial  
14 condition. On Plaintiffs’ information and belief, O’Meara actively managed Lehman Brothers’ Repo  
15 105 activity, and knowingly and intentionally authorized, approved and/or ratified the increase of  
16 such activity in late 2007 and 2008 to conceal that financial condition so as to falsely convince  
17 counterparties, including Plaintiffs, that Lehman Brothers was materially financially stronger than  
18 it really was. O’Meara also continually and regularly apprised the Director Defendants of Lehman  
19 Brothers’ increasing risk limits and plans to reduce net leverage which, on Plaintiffs’ information  
20 and belief, included discussions regarding the Repo 105 program. On Plaintiffs’ information and  
21 belief, during his employment with the company, O’Meara was a stockholder in Lehman Brothers.

22       117. **Callan** joined Lehman Brothers in 1995, having represented Lehman Brothers as  
23 outside counsel the previous 5 years at Simpson Thatcher& Bartlett, and thus she was also at Lehman  
24 Brothers during the 1998 refinancing. Prior to becoming Lehman Brothers’ CFO from December  
25 2007 to June 2008, Callan spent several years in Lehman Brothers’ Investment Banking Division,  
26 as Managing Director from 2000 and 2003 and as Head of Global Finance Solution Group and  
27 Global Finance Analytics Group from 2003 and 2006. Callan then became Head of Global Hedge  
28 Fund Coverage in 2006 until she was promoted to CFO in December 2007. Callan was also

1 knowledgeable of Lehman Brothers' Repo 105 activity, and falsely reported publicly during her  
2 tenure as CFO that Lehman Brothers was reducing its leverage without disclosing that Repo 105  
3 activity. On Plaintiffs' information and belief, Callan also apprised the Director Defendants of the  
4 increases in Lehman's Brothers' leverage and risk positions. On Plaintiffs' information and belief,  
5 during her employment with the company, Callan was a stockholder in Lehman Brothers.

6 118. The Director Defendants, as further detailed below, consisted of highly accomplished  
7 professionals who purportedly demonstrated high ethical standards and integrity, high intelligence  
8 and wisdom, were financially literate, were supposedly willing to raise tough questions in a manner  
9 that encouraged open discussion and ask for and use information to make informed judgments and  
10 assessments, and possessed skills and experience to provide strategic and management oversight to  
11 help maximize the long-term value of Lehman Brothers. Nonetheless, despite being extremely well-  
12 informed of, and having access to any information regarding Lehman Brothers' activities,  
13 investments and financial condition, the Director Defendants abdicated their fundamental functions  
14 and were complicit in the issuance of false and misleading financial statements by, among other  
15 things, turning a blind eye to the decisions of senior management and failing to serve as an  
16 independent counterbalance to senior management, particularly the Officer Defendants. Despite  
17 being well-informed of Lehman Brothers' activities and financial condition, the Director Defendants  
18 also turned a blind eye to obvious warning signs that the financial statements they signed, authorized  
19 and ratified were materially false and misleading, that Lehman Brothers had taken on too much risk  
20 during the subprime mortgage crisis and was grossly over leveraged, and that there had been related  
21 corporate malfeasances by senior management, including the Officer Defendants.

22 119. **Ainslie** was a member of the Board of Directors of Lehman Brothers from 1996 to  
23 2008 and served on Lehman Brothers' Audit Committee. Prior to serving on Lehman Brothers'  
24 Board of Directors, Ainslie served as the Chief Executive Officer and Director of Sotheby's  
25 Holdings from 1984 to 1994, and as President and Chief Executive Officer of the National Trust for  
26 Historic Preservation from 1980 to 1984. On Plaintiffs' information and belief, he was also a  
27 shareholder in Lehman Brothers and had a personal financial interest in maintaining a high stock  
28 price for the company by, among other things, representing that Lehman Brothers was solvent.

1           120. **Akers** was a member of the Board of Directors of Lehman Brothers from 1996 to  
2 2008, chaired the Compensation and Benefits Committee, and served on the Finance and Risk  
3 Committee. Prior to serving on Lehman Brothers' Board of Directors, Akers was employed by the  
4 technology giant International Business Machines Corporation (IBM) for 33 years, and served as  
5 IBM's Chief Executive Officer from 1985 to 1993 and Chairman of the Board from 1986 to 1993.  
6 Akers is also a former member of the Board of Trustees of the California Institute of Technology and  
7 The Metropolitan Museum of Art, and was the former Chairman of the Board of Governors of  
8 United Way of America. Currently, Akers is a Director of W.R. Grace & Company. On Plaintiffs'  
9 information and belief, he was also a shareholder in Lehman Brothers and had a personal financial  
10 interest in maintaining a high stock price for the company by, among other things, representing that  
11 Lehman Brothers was solvent.

12           121. **Berlind** was a member of the Board of Directors of Lehman Brothers from 1985 to  
13 2008, and served as a member of Lehman Brothers' Audit Committee and Finance and Risk  
14 Committee. Since 1976, Berlind has been a theatrical producer or co-producer of over 40 plays and  
15 musicals, all of which required accounting and financial knowledge and skills. Berlind was also one  
16 of the founders of Carter, Berlind, Potoma & Weill, an investment banking and brokerage firm that  
17 later became Shearson Loeb Rhoades. On Plaintiffs' information and belief, he was also a  
18 shareholder in Lehman Brothers and had a personal financial interest in maintaining a high stock  
19 price for the company by, among other things, representing that Lehman Brothers was solvent.

20           122. **Cruikshank** was a member of the Board of Directors of Lehman Brothers from 1996  
21 to 2008, and served as the Chairman of Lehman Brothers' Audit Committee and was determined by  
22 the Board of Directors to be an "audit committee financial expert" as defined by Securities and  
23 Exchange Commission ("SEC") rules. Cruikshank was also a member of Lehman Brothers'  
24 Nominating and Corporate Governance Committee. Prior to serving as a director of Lehman  
25 Brothers, Cruikshank was a long time employee of the petroleum industry service giant Halliburton  
26 Company, for which he served as its Chairman and Chief Executive Officer from 1989 to 1995,  
27 President and Chief Executive Officer of Halliburton from 1983 to 1989, and as a director from 1977  
28 to 1996. On Plaintiffs' information and belief, he was also a shareholder in Lehman Brothers and

1 had a personal financial interest in maintaining a high stock price for the company by, among other  
2 things, representing that Lehman Brothers was solvent.

3 123. **Evans** was a member of the Board of Directors of Lehman Brothers from 2004 to  
4 2008, and also served on the Nominating and Corporate Governance Committee (for which she  
5 served as Chairman), the Compensation and Benefits Committee, and the Finance and Risk  
6 Committee. Previously, Evans was a career officer with the United States Navy, and retired in 1998  
7 as a Rear Admiral. During her naval career, Evans served as superintendent of the Naval  
8 Postgraduate School in Monterrey, California from 1995 to 1998 and was the head of the Navy's  
9 worldwide recruiting organization from 1993 to 1995. Evans also previously served as the President  
10 and Chief Executive Officer of the American Red Cross from 2002 to 2005, and as the National  
11 Executive Director of the Girl Scouts of the USA from 1998 to 2002. Evans has also been a Director  
12 of Weight Watchers International, the North Highland Company and The Estate of Lehman Brothers  
13 Holdings. On Plaintiffs' information and belief, she was also a shareholder in Lehman Brothers and  
14 had a personal financial interest in maintaining a high stock price for the company by, among other  
15 things, representing that Lehman Brothers was solvent.

16 124. **Gent** was a member of the Board of Directors of Lehman Brothers from 2003 to  
17 2008, and served on its Audit Committee and Compensation and Benefits Committee. Since 2005,  
18 Gent has also served as the Chairman of the multinational pharmaceutical, biologics, vaccines and  
19 consumer healthcare company GlaxoSmithKline. Until his retirement in 2003, Gent was a member  
20 of the Board of Directors of telecommunications giant Vodafone since 1985, and also served as the  
21 company's Chief Executive Officer since 1997. Gent is currently a Non-Executive Director of  
22 Ferrari SpA, a member of KPMG's Chairman's Advisory Group and a Senior Adviser at Bain & Co.  
23 On Plaintiffs' information and belief, he was also a shareholder in Lehman Brothers and had a  
24 personal financial interest in maintaining a high stock price for the company by, among other things,  
25 representing that Lehman Brothers was solvent.

26 125. **Hernandez** was a member of the Board of Directors of Lehman Brothers from 2005  
27 to 2008, and served on the Finance and Risk Committee. Hernandez is the retired Chairman and  
28 Chief Executive Officer of Telemundo Group, Inc., a Spanish-language television company, where

1 he served from 1998 to 2000. From 1995 to 1998, Hernandez also served as President and Chief  
2 Executive Officer of Telemundo Group, Inc. Hernandez is currently a Director of Ryland Group,  
3 Inc., Vail Resorts, Inc., Sony Corporation, MGM Resorts International, and U.S. Bancorp.  
4 Hernandez previously served as a Director of Wal-Mart Stores, Inc., where he served on the  
5 company's Audit Committee and was determined to be an "audit committee financial expert" as  
6 defined by SEC rules. On Plaintiffs' information and belief, he was also a shareholder in Lehman  
7 Brothers and had a personal financial interest in maintaining a high stock price for the company by,  
8 among other things, representing that Lehman Brothers was solvent.

9       126. **Kaufman** was a member of the Board of Directors of Lehman Brothers from 1995  
10 to 2008, and served as Chairman of the Finance and Risk Committee. Kaufman concurrently served  
11 as President of Henry Kaufman & Company, Inc., an investment management and economic and  
12 financial consulting firm, since 1988. For twenty six years, Kaufman was with Salomon Brothers  
13 Inc., where he served a managing director, vice chairman, and a member of the executive committee,  
14 and was in charge of Salomon Brothers Inc.'s four research departments. Prior to joining Salomon  
15 Brothers, Inc., Kaufman served as an economist at the Federal Reserve Bank of New York.  
16 Kaufman is the author of several books, including *On Money and Markets*, *Interest Rates, the*  
17 *Markets and the New Financial World*, and *The Road to Financial Reformation*, in which he  
18 purports to "reveal[] the mistakes that got us into this debacle [of the 2008 financial crisis], the  
19 consequences—as they have not been fully realized—and how to put our derailed economy back on  
20 track," including "[i]ntensive official supervision [which] will help make financial conglomerates  
21 too good to fail." On Plaintiffs' information and belief, he was also a shareholder in Lehman  
22 Brothers and had a personal financial interest in maintaining a high stock price for the company by,  
23 among other things, representing that Lehman Brothers was solvent.

24       127. **Macomber** was a member of the Board of Directors of Lehman Brothers from 1994  
25 to 2008, and served with Fuld on the Executive Committee. Macomber also served on Lehman  
26 Brothers' Compensation and Benefits Committee and Nominating and Corporate Governance  
27 Committee. Macomber has also served as a Principal of JDM Investment Group, a private  
28 investment firm, since 1992, was the former Chairman and President of the Import-Export Bank of



1 the United States since 1989 to 1992, and was the Chairman and Chief Executive Officer of Celanese  
2 Corporation from 1973 to 1986. On Plaintiffs' information and belief, he was also a shareholder in  
3 Lehman Brothers and had a personal financial interest in maintaining a high stock price for the  
4 company by, among other things, representing that Lehman Brothers was solvent.

5 128. Among other things, Lehman Brothers' Audit Committee, which consisted of  
6 **Cruikshank** (the committee chair and an "audit committee financial expert"), **Ainslie**, **Berlind** and  
7 **Gent**, was tasked with assisting the Board of Directors in fulfilling its oversight of the quality and  
8 integrity of Lehman Brothers' financial statements and compliance with legal and regulatory  
9 requirements (like the S.E.C. Order), received regular reporting from O'Meara and Callan regarding  
10 the state of Lehman Brothers' financial condition and, on Plaintiffs' information and belief, knew  
11 of and/or ratified the company's accounting manipulations (including the Repo 105 program) and/or  
12 knew that Lehman Brothers' financial statements materially misrepresented the company's leverage  
13 positions during the worsening subprime mortgage crisis. On Plaintiffs' information and belief,  
14 despite their access to company documents and employees, the Audit Committee and its members  
15 failed to conduct an adequate investigation into the veracity of Lehman Brothers' financial  
16 statements in response to public and internal criticism of Lehman Brothers' financial reporting in  
17 2008, but turned a blind eye to obvious red flags that the financial statements were false and  
18 misleading.

19 129. In addition, Lehman Brothers' Finance and Risk Committee, which was tasked with  
20 the responsibility of reviewing and advising the Board of Directors on the financial policies and  
21 practices of Lehman Brothers, including risk management, and consisted of **Kaufman**, **Akers**,  
22 **Berlind**, **Evans**, and **Hernandez**, knew of and/or ratified Lehman Brothers' balance sheet  
23 manipulations. The Finance and Risk Committee members received regular reporting on Lehman  
24 Brothers' increasing risk appetite usage and plans to reduce stated leverage which, on Plaintiffs'  
25 information and belief, included discussions of the Repo 105 program and the vast accumulation of  
26 illiquid commercial and residential real estate assets. Despite access to company documents and  
27 employees, the Finance and Risk Committee, which included Kaufman, a renowned economist who  
28 has purported to understand the causes of the 2008 financial crisis, and Hernandez, an "audit

1 committee financial expert,” intentionally failed to disclose and/or consciously ignored the risk and  
2 illiquidity that Lehman Brothers assumed during the subprime mortgage crisis which severely  
3 threatened the company’s survival.

4 130. With Fuld, **Macomber** was a member of the Executive Committee. Plaintiffs are  
5 informed and believe that Macomber was expressly informed, both orally and in writing, and  
6 intentionally failed to disclose that Lehman Brothers was severely over-leveraged and over-exposed  
7 to subprime mortgage backed securities and/or other real estate-related investments and, despite that  
8 knowledge, authorized and/or ratified the issuance of financial statements that concealed Lehman  
9 Brothers’ deteriorating financial condition and Repo 105 activity.

10 **B. Lehman Brothers’ Financial Statements, Which Were Authorized And Signed**  
11 **By The Individual Lehman Defendants, Continually Represented Growth From**  
12 **The Company’s Subprime Mortgage Business.**

13 131. In or about the mid-2000s, Lehman Brothers became the market leader in the  
14 subprime mortgage industry by, among other things, lending billions of dollars to other financial  
15 institutions to fund subprime mortgages, originating its own subprime mortgage loans, and  
16 purchasing subprime mortgages to package and sell as asset-backed securities to global investors.

17 132. Prior to its bankruptcy, Lehman Brothers boasted about its “record” and “robust”  
18 profits earned from its holdings in the subprime market. In its 2005 Form 10-K filed with the SEC  
19 on February 13, 2006, Lehman Brothers explained that its holdings in the subprime market  
20 represented a significant portion of its business:

21 Fixed Income net revenues were a record \$7.3 billion in 2005, increasing 28%  
22 compared with 2004 driven by double digit revenue increases from each geographic  
23 region and record revenues across a number of businesses including commercial  
24 mortgage and real estate, residential mortgage origination and securitization, and  
25 interest rate products. Revenues from our commercial mortgage and real estate  
26 businesses increased substantially in 2005 reaching record levels, as the strong  
27 demand for commercial real estate properties, the recovery in certain property  
28 markets and relatively low interest rates drove asset sales and robust levels of  
securitizations. Revenues from our residential mortgage origination and  
securitization businesses increased in 2005 from the robust levels in 2004, reflecting  
record volumes and the continued benefits associated with the vertical integration of  
our mortgage origination platforms . . . The mortgage securitization business was  
notably strong, with revenues in mortgage products benefitting from the low rate  
environment as well as the continued vertical integration of our low mortgage  
origination platforms.

1 133. The 2005 10-K Form was authorized, signed and ratified by the Individual Lehman  
2 Defendants Fuld, O'Meara, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman,  
3 and Macomber.

4 134. In its 2006 10-K Form filed with the SEC on February 13, 2007, Lehman Brothers  
5 reported that its fixed income net revenues purportedly continued to grow "to a record \$8.4 billion  
6 in 2006, an increase of 15% from 2005."

7 135. However, Lehman Brothers' 2006 10-K Form reported for the first time that, despite  
8 its continued growth, it had witnessed a decrease in revenues from its residential mortgage  
9 origination and securitization businesses that "was primarily attributable to a softer housing market  
10 and lower margins." But nowhere in its 2006 10-K Form did Lehman Brothers acknowledge the  
11 potential devastating impact of its substantial holdings in the subprime market on its operations as  
12 a whole. Instead, Lehman Brothers claimed that increased interest rates and a downturn in the  
13 housing market would affect only a few of its businesses, and that it maintained "sufficient liquidity  
14 to meet all of [its] funding obligations in all market environments."

15 136. The 2006 10-K Form was authorized, signed and ratified by the Individual Lehman  
16 Defendants Fuld, O'Meara, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman,  
17 and Macomber.

18 137. According to Lehman Brothers' 2007 10-K Form, which was filed with the SEC on  
19 January 29, 2008 (a mere eight months prior to bankruptcy), its overall revenues continued to climb:

20 On the basis of a record first half and a reasonably successful navigation of difficult  
21 market conditions in the second half, we achieved our fourth consecutive year of  
22 record net revenues, net income and diluted earnings per common share in 2007. Net  
23 income totaled \$4.2 billion, \$4.0 billion and \$3.3 billion in 2007, 2006 and 2005,  
24 respectively, increasing 5% in 2007 and 23% in 2006 from the corresponding 2006  
and 2005 periods, respectively. Diluted earnings per common share were \$7.26,  
\$6.81 and \$5.43 in 2007, 2006 and 2005, respectively, up 7% in 2007 and 25% in  
2006 from the corresponding prior periods, respectively.

25 138. Despite its reported continued growth, financial strength and stability, Lehman  
26 Brothers acknowledged that the "difficult" latter half of 2007 witnessed a "deterioration within the  
27 U.S. subprime residential mortgage asset category, the weakening of the U.S. housing sector became  
28 worse than most observers expected," and a decrease in investor confidence in the subprime

1 securities market “which, in part, led to many market participants re-pricing assets and taking large  
2 write-downs.” However, Lehman Brothers again minimized any risks its own subprime holdings  
3 posed to the overall health of the company, and communicated a fictional and false impression of  
4 financial strength and stability, stating that:

5 During the latter half of our 2007 fiscal year, the global capital markets experienced  
6 a significant contraction in available liquidity as the adverse market environment  
7 experienced in our third quarter continued into our fourth quarter and deteriorated  
8 further in November 2007. Despite infusions of liquidity by central banks into the  
9 financial system, broad asset classes, particularly U.S. subprime residential  
10 mortgages and structured credit products, remained thinly traded throughout this  
11 period. Notwithstanding these global market conditions, we ended the period with  
12 a very strong liquidity position. At November 30, 2007, our liquidity pool was  
approximately \$35 billion, up from approximately \$31 billion at November 30, 2006  
and down slightly from approximately \$36 billion at the end of the third quarter of  
the 2007 fiscal year. Long-term capital (long-term borrowings, excluding borrowings  
with remaining contractual maturities within twelve months of the financial  
statement date, and total stockholders' equity) was at approximately \$146 billion at  
the end of 2007 fiscal year, up from approximately \$100 billion at November 30,  
2006 and \$142 billion at the end of the third quarter of the 2007 fiscal year.

13 139. The 2007 10-K Form was authorized, signed and ratified by the Individual Lehman  
14 Defendants Fuld, Callan, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman,  
15 and Macomber.

16 140. Additionally, Lehman Brothers' 2007 Annual Report, which was expressly to be  
17 provided to Plaintiffs pursuant to Lehman Brothers' obligations under the 2008 Swap and which was  
18 signed by Fuld on February 15, 2008, contained the same statements and representations as the 2007  
19 10-K. The 2007 Annual Report emphasized Lehman Brothers' “financial strength” and claimed  
20 “another year of record net revenues, net income, and earnings per share” and a “record performance  
21 across each of our business segments as well as in Europe and Asia.” As part of the 2007 Annual  
22 Report “Financial Highlights,” Lehman Brothers emphasized its Net leverage ratio, which was stated  
23 as 16.1x and which was claimed to be more “useful” and “meaningful” than Lehman Brothers'  
24 Leverage ratio, which was reported as 30.7x. The 2007 Annual Report went on to state:

25 Our revenues have never been more evenly balanced across our businesses, and we  
26 have achieved our best-ever geographic diversification, with half of the Firm's  
27 revenue generated outside the Americas. The result of all this is that we have built  
a balanced global investment bank – able to withstand the stresses of rapid shifts in  
world liquidity flows.

28 The Annual Report went on to emphasize Lehman Brothers solid balance sheet and emphasized that:

1 We effectively managed our risk, balance sheet, and expenses. Ultimately, our  
2 performance in 2007 was about our “One Firm” sense of shared responsibility and  
3 careful management of our liquidity, capital commitments, and balance sheet  
4 positions. We benefitted from our senior level focus on risk management and, more  
5 importantly, from a culture of risk management at every level of the firm. (Emphasis  
6 added)

7 Included in this “senior level focus” and “risk management at every level of the Firm” were each of  
8 the material misrepresentations made by the Individual Lehman Defendants as described further  
9 below. A true and correct copy of the very first page of the 2007 Annual Report is attached hereto  
10 as Exhibit I. Notably, this first page snapshot of Lehman Brothers’ financial condition gives the  
11 false impression of financial solvency and stability, as intended by the Individual Lehman  
12 Defendants and is based on and materially similar to the financial data in the 2007 Form 10-K,  
13 signed by Defendants Callan, Fuld, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez,  
14 Kaufman, and Macomber.

15 **C. The Individual Lehman Defendants Used “Repo 105” and “Repo 108”**  
16 **Transactions to Create a Materially Misleading Picture of the Firm’s Financial**  
17 **Condition**

18 141. As early as 2007, at the same time they were reporting robust growth in Lehman  
19 Brothers’ financial statements, the Individual Lehman Defendants were acutely aware that the  
20 weakening of the United States housing market and the subprime mortgage crisis would have a  
21 devastating impact on the company. At a Board of Directors meeting on March 20, 2007 that Fuld,  
22 O’Meara, Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman and Macomber  
23 attended, these Defendants were expressly informed that, while the subprime mortgage business had  
24 previously been an attractive and profitable market for Lehman Brothers, steeply declining housing  
25 prices had “led to declining profitability among all industry participants and . . . that overcapacity  
26 had led to reduced pricing and increased risk taking, lowering overall profitability.” Fuld, O’Meara,  
27 Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman and Macomber were also  
28 expressly informed that, as a result of this downturn, “virtually all independent subprime originators  
have cut back on their operations or have gone out of business” and “most of the large subprime  
independents have gone out of business, have been sold or are selling.”

1 142. Despite this information and these warnings, Fuld, O’Meara, Ainslie, Akers, Berlind,  
2 Cruikshank, Evans, Gent, Hernandez, Kaufman and Macomber nevertheless authorized Lehman  
3 Brothers to increase the company’s risk appetite and pursue a strategy in which, among other things,  
4 it would continue to aggressively originate subprime loans and during the crisis despite Lehman  
5 Brothers’ weakening financial condition, Fuld, O’Meara, Ainslie, Akers, Berlind, Cruikshank,  
6 Evans, Gent, Hernandez, Kaufman and Macomber authorized Lehman Brothers to continue  
7 originating sub-prime and other risky loans, which would purportedly better position the company  
8 for profitable growth once the industry cycle turned.

9 143. However, the Individual Lehman Defendants immediately saw signs that their  
10 strategy was failing and the subprime crisis could have a spillover effect upon Lehman Brothers’  
11 other business lines. At a September 11, 2007 meeting of the Finance and Risk Committee, O’Meara  
12 informed committee members Kaufman, Akers, Berlind, Evans and Hernandez that the subprime  
13 crisis had worsened significantly, stating “[c]ontagion from the sub-prime mortgage loan market  
14 gradually spread to other mortgage loan markets . . . and eventually to the general credit market” and  
15 that these difficulties “contributed to the failure of certain high profile hedge funds exposed to the  
16 sub-prime mortgage loan market and other highly levered [sic] credit products” and caused  
17 “numerous mortgage originators . . . fil[ing] for bankruptcy or . . . discontinu[ing] operations.”  
18 O’Meara also reiterated that the crisis had caused “numerous mortgage originators” “have filed for  
19 bankruptcy or have discontinued operations.” As a result, O’Meara informed Kaufman, Akers,  
20 Berlind, Evans and Hernandez that, on or about July 2007, Lehman Brothers had scaled back its  
21 strategy and “discontinued origination of sub-prime mortgages.” O’Meara also informed Kaufman,  
22 Akers, Berlind, Evans and Hernandez that Lehman Brothers was vulnerable to substantial losses,  
23 noting that Lehman Brothers’ “stress tests consistently forecasted greater stressed losses than actual  
24 losses.”

25 144. At a January 29, 2008 meeting of the Finance and Risk Committee, O’Meara, Callan,  
26 Kaufman, Akers, Berlind, Evans, and Hernandez discussed the “composition of the Firm’s net assets,  
27 equity and leverage levels,” “the increase in the Firm’s risk appetite limit” from \$2.5 billion in first  
28 quarter 2007 to the current \$3.7 billion, and that Lehman Brothers’ “Level 3 assets have grown as

1 a proportion of the inventory of the Firm,” which were “primarily concentrated in residential and  
2 commercial mortgages, in light of the reduction in market liquidity and price transparency for such  
3 assets.” Materials were distributed to the Defendants present at the meeting and Fuld that  
4 acknowledged that “turmoil in the credit markets that [were] discussed in the September [2007]  
5 Finance and Risk Committee has continued, with significant volatility in spreads and tight liquidity  
6 positions,” while at the same time Lehman Brothers’ risk appetite continued to increase through the  
7 fourth quarter 2007. Those same materials also noted that Lehman Brothers has “been able to grow  
8 repo financing to meet the balance sheet and leverage increases, without reducing the term of that  
9 financing.” (Emphasis added).

10 145. As committee chair, Kaufman presented the Finance and Risk Committee’s report  
11 to the Board of Directors at a meeting held later on January 29, 2008 and attended by Fuld, Callan,  
12 Ainslie, Akers, Berlind Cruikshank, Evans, Gent, Hernandez, Kaufman and Macomber. Kaufman  
13 “discussed balance sheet growth, particularly in mortgage and loan assets, and noted the increase in  
14 the Firm’s leverage at fiscal year-end.” However, the materials distributed at the Board of Directors  
15 meeting noted that “very few of the top financial issuers have been able to escape damage from the  
16 subprime fallout” and that those issuers recently reported several billions in credit losses and write-  
17 downs. The materials also noted that “economic growth slowing down in all major markets,” “U.S.  
18 housing crisis more severe than previously anticipated,” “outlook uncertainty is much higher than  
19 usual.” Despite these dire warnings and Lehman Brothers’ deteriorating financial condition, it was  
20 still recommended for Lehman Brothers to increase risk appetite limit in 2008 and continue to  
21 “pursue a countercyclical growth strategy . . . to improve its competitive position and, over time,  
22 generate superior returns for our shareholders.”

23 146. As market conditions, particularly subprime, deteriorated and the pressures on  
24 Lehman Brothers to reduce its net leverage ratio increased, the Individual Lehman Defendants  
25 authorized and/or ratified the significant expansion of use of “Repo 105” transactions, which had  
26 been previously used for years to temporarily remove securities inventory from its balance sheet,  
27 usually for a period of seven to ten days, and create a materially misleading picture of its financial  
28 condition, in late 2007 to 2008.

1           147. Repo 105 transactions were nearly identical to standard repurchase and resale (“repo”) transactions that Lehman Brothers (and other investment banks) used to secure short-term financing, with a critical difference: Lehman Brothers accounted for Repo 105 transactions as “sales” as opposed to secured financing transactions (as would be the case in a standard repo), solely for misleading financial reporting purposes. By recharacterizing the Repo 105 transaction as a “sale,” Lehman Brothers removed the inventory from its balance sheet. Lehman Brothers used the cash from the Repo 105 transaction to pay down other liabilities, thereby reducing both the total liabilities and the total assets reported on its balance sheet and lowering its leverage ratios.

2           148. Moreover, due to the fact that Repo 105 transactions were employed solely to create a distorted and materially misleading financial picture, Lehman Brothers regularly increased its use of Repo 105 transactions in the days prior to reporting periods to reduce its publicly reported net leverage and balance sheet. Then, a few days after the new quarter began, Lehman Brothers would borrow the necessary funds to repay the cash borrowing plus interest, repurchase the securities, and restore the assets to its balance sheet. The only purpose or motive for undertaking Repo 105 transactions at or near each quarter-end was to, temporarily, reach quarter-end balance sheet targets set by senior Lehman Brothers management in order to report lower leverage and lower net leverage ratios than Lehman Brothers actually had.

3           149. As a result, the optimistic view of Lehman Brothers’ financial condition reported in its 2007 Annual Report, Form 10-Q and Form 10-K statements, which were signed, authorized and/or ratified by the Individual Lehman Defendants, was misleading, and concealed accounting manipulations and did not disclose the cash borrowing from the Repo 105 transactions, either by name or characterization – although Lehman Brothers had borrowed tens of billions of dollars in these transactions. Even though these transactions were directly responsible for the presented picture of Lehman Brothers’ financial “health,” Lehman Brothers’ financial statements did not disclose the known obligations to repay the massive debt arising from the Repo 105 transactions.

4           150. In Note 1 “Summary of Significant Accounting Policies” of Lehman Brothers 2007 Form 10-K, first quarter 2008 Form 10-Q, and second quarter 2008 Form 10-Q, Lehman Brothers stated that it treated repos as “collateralized agreements and financings for financial reporting



1 purpose” which Lehman Brothers described were “collateralized primarily by government and  
2 government agency securities.” In addition, Lehman Brothers further stated in each filing: “Other  
3 secured borrowings principally reflect transfers accounted for as financings rather than sales under  
4 [Statement of Financial Accounting Standards] 140.” On Plaintiffs’ information and belief, the  
5 Individual Lehman Defendants consistently misrepresented that it treated repo transactions as  
6 financing transactions “for financial reporting purposes,” without disclosing that Lehman Brothers  
7 treated some repos as sales.

8 151. Lehman Brothers’ Item 7 “Management’s Discussion and Analysis of Financial  
9 Condition and Results of Operations” (“MD&A”) for its 2007 Form 10-K and Forms 10-Q for the  
10 first and second quarter 2008 were also misleading with respect to Lehman Brothers’ liabilities. The  
11 MD&A section to Lehman Brothers’ 2007 Form 10-K discussed the net leverage ratio without  
12 disclosing the role that Repo 105 transactions played in that calculation. Lehman Brothers’  
13 disclosure in the Liquidity, Funding, and Capital Resources section of the MD&A should have  
14 included a discussion of what was known with respect to the timing and/or amounts of the cash flow  
15 created by the repayment of the Repo 105 cash borrowing in the first seven to ten days after  
16 quarter-end, but did not.

17 152. On Plaintiffs’ information and belief, the Individual Lehman Defendants temporarily  
18 reduced the firm’s net balance sheet at quarter-end through Lehman Brothers’ Repo 105 practice by  
19 approximately \$38.6 billion (9%) in fourth quarter 2007, \$49.1 billion (12%) in first quarter 2008,  
20 and \$50.38 billion (15%) in second quarter 2008. As a result of its quarter-end Repo 105 practice  
21 from late 2007 through the second quarter 2008, Lehman Brothers publicly reported a net leverage  
22 ratio that was 1.7 to 1.9 points lower than what its net leverage ratio would have been if the Lehman  
23 Brothers had used ordinary repo transactions instead of Repo 105 transactions, thereby knowingly  
24 creating a false picture of solvency to counterparties such as Plaintiffs and to the rating companies.

25 153. The Individual Lehman Defendants never publicly disclosed Lehman Brothers’ use  
26 of Repo 105 transactions, Lehman Brothers’ accounting treatment for these transactions, the  
27 considerable escalation of its total Repo 105 usage in late 2007 and into 2008, or the material impact  
28 these transactions had on the firm’s publicly reported net leverage ratio.

1           154. In March 2008, Lehman Brothers' investment banking peer Bear Stearns collapsed  
2 under the weight of its involvement in the subprime mortgage industry. Bear Stearns' failure made  
3 it clear that Lehman Brothers' countercyclical strategy approved by the Individual Lehman  
4 Defendants had failed. The Individual Lehman Defendants knew that Lehman Brothers was very  
5 likely the next major investment bank that would fail, but made no disclosures to Plaintiffs or anyone  
6 else that the Firm's financial statements and their representations of Lehman Brothers' solvency were  
7 not true.

8           155. On March 25, 2008, O'Meara, Callan, Kaufman, Akers, Berlind, Evans and  
9 Hernandez discussed Bear Stearns' failure and the potential impacts on the Lehman Brothers'  
10 business model going forward at a meeting of the Finance and Risk Committee. Reviewing Lehman  
11 Brothers' liquidity position and leverage, the committee members discussed Lehman Brothers'  
12 Level III assets and plans to reduce the company's leverage which, on Plaintiffs' information and  
13 belief, included discussions regarding the Repo 105 program. At a Board of Directors meeting later  
14 that day attended by Fuld, O'Meara, Callan, Ainslie, Akers, Berlind, Cruikshank, Evens, Gent,  
15 Hernandez, Kaufman, and Macomber, Kaufman, Callan and O'Meara presented the findings and  
16 conclusions of the Finance and Risk Committee to the Board of Directors which, on Plaintiffs'  
17 information and belief, included discussions on Lehman Brothers' leverage reduction and the Repo  
18 105 program.

19           156. On Plaintiffs' information and belief, no later than March 2008 – twelve days before  
20 signing Lehman Brothers' first quarter Form 10-Q – CEO and Chairman of the Board Fuld was  
21 informed that Lehman Brothers' quarter-end Repo 105 transactions for first quarter 2008 reduced  
22 Lehman's net balance sheet by \$49.1 billion. Fuld met regularly with senior management and  
23 members of the Executive Committee, which consisted of himself, Callan, Defendant Macomber and  
24 others, to discuss the state of the company. On Plaintiffs' information and belief, on or about March  
25 28, 2008, Executive Committee members Fuld, Callan and Macomber as well as Chief Risk Officer  
26 O'Meara were provided with materials that expressly discussed Lehman Brothers' Repo 105  
27 program and its \$49.1 billion quarter-end Repo 105 usage for first quarter of 2008. On Plaintiffs'  
28 information and belief, at a March 28, 2008 meeting of the Executive Committee that Callan and

1 Macomber attended, a request was made to freeze Lehman Brothers' Repo 105 usage, which was  
2 not implemented.

3 157. On Plaintiffs' information and belief, in June 2008, Lehman's "Balance Sheet Czar"  
4 Bart McDade spoke to Fuld about reducing Lehman Brothers' use of Repo 105 transactions.  
5 McDade discussed with Fuld, who was familiar with the term Repo 105, Lehman Brothers' \$38.6  
6 billion Repo 105 volume at year-end 2007 and \$49.1 billion Repo 105 volume at first quarter-end  
7 2008. At this meeting, McDade advised Fuld that Lehman Brothers should reduce its Repo 105  
8 usage to \$25 billion.

9 158. On Plaintiffs' information and belief, in June 2008, only weeks before he signed  
10 Lehman Brothers' second quarter Form 10-Q, Fuld had actual knowledge of Lehman Brothers'  
11 quarter-end Repo 105 usage for that quarter, and that he had been expressly informed that "of  
12 Lehman's quarter-end Repo 105 usage – \$38.6 billion at year-end 2007; \$49.1 billion at first quarter  
13 2008; and \$50.38 billion at second quarter 2008." Despite this express knowledge, Fuld failed to  
14 disclose that Lehman Brothers' financial statements materially misrepresented the company's  
15 financial condition and its accounting treatment for repo transactions. Instead, Fuld falsely stated  
16 that Lehman Brothers' capital position had "never been stronger," again without disclosure of the  
17 Repo 105 transactions, which created a materially misleading financial picture.

18 159. On Plaintiffs' information and belief, O'Meara actively managed Lehman Brothers'  
19 Repo 105 activity and knew that the program caused the company's financial statements to  
20 materially misrepresent its financial condition and stated leverage. O'Meara's involvement in  
21 Lehman Brothers' Repo 105 program includes the following:

22 • As Lehman Brothers' CFO, O'Meara was directly involved in establishing  
23 firm-wide limits on Repo 105 activity no later than mid-2006 through December 1, 2007.

24 • As Lehman Brothers' CFO, an increase in the Repo 105 cap required his  
25 authorization, and O'Meara authorized such an increase from \$22 billion to \$25 billion in  
26 February 2007.

27 • O'Meara regularly discussed Repo 105 limits and Lehman Brothers' reliance  
28 on Repo 105 with senior management, including in mid-to-late 2007, when Lehman Brothers

1 increased its use of Repo 105 transactions.

2 • As CFO and Chief Risk Officer, O'Meara continually worked with members  
3 of Lehman Brothers' Finance and Risk Committee, which consisted of Defendants Kaufman,  
4 Berlind, Evans and Hernandez, to discuss and set balance sheet targets and net leverage ratio  
5 targets and, on Plaintiffs' information and belief, discussed the Repo 105 program.

6 • O'Meara knew that the purpose of, and a consequence of, undertaking Repo  
7 105 transactions was balance sheet reduction, particularly at quarter-end, and between April  
8 2008 and September 2008, when O'Meara was Lehman Brothers' Chief Risk Officer,  
9 regularly received Daily Balance Sheet and Disclosure Scorecards wherein the consolidated  
10 balance sheet routinely tracked the reduction to Lehman Brothers' balance sheet caused by  
11 Repo 105.

12 160. From late 2007 to early 2008, when O'Meara served as Lehman Brothers' CFO and/or  
13 Chief Risk Officer, the volume of Repo 105 transactions expanded significantly, and rose to \$38  
14 billion at the close of Lehman Brothers' fourth quarter of 2007.

15 161. While serving as CFO of Lehman Brothers from December 2007 to June 2008, Callan  
16 was also expressly informed of Lehman Brothers' Repo 105 practices, and that these transactions  
17 caused Lehman Brothers' financial statements to materially misrepresent the company's financial  
18 condition. During meetings in early 2008 with Lehman Brothers' Global Financial Controller,  
19 Callan was informed that, among other things, "the large size of the Repo 105 program presented  
20 'headline risk,'" because Lehman Brothers' Repo 105 transactions were not disclosed in its publicly  
21 filed financial statements, the company had "exposed itself to 'reputational risk' if its use of Repo  
22 105 were to become public," that "Repo 105 transactions lacked economic substance, and were used  
23 to reduce net balance sheet primary at quarter-end," and it was reasonably believed that "none of  
24 Lehman Brothers' peer investment banks used Repo 105-type transactions." As early as January 3,  
25 2008, Callan was informed by Lehman's Global Product Controller that "repo 105 liquidity was very  
26 tight."

27 162. Callan was further informed of the potential risks or problems with Lehman Brothers'  
28 use of Repo 105 transactions during a March 28, 2008 Executive Committee meeting, which on

1 Plaintiffs' information and belief Defendants Fuld and Macomber also attended, where a request was  
2 made to freeze Lehman Brothers' Repo 105 usage and the related materials expressly discussed  
3 Lehman Brothers' \$49.1 billion quarter-end Repo 105 usage for first quarter of 2008. Starting in  
4 April 2008, Callan also received the Daily Balance Sheet and Disclosure Scorecard, through which  
5 she was informed on a regular basis of the impact of Repo 105 transactions on Lehman Brothers'  
6 firm-wide balance sheet. Despite this knowledge, on April 9, 2008, Callan signed Lehman Brothers'  
7 quarterly report without disclosing the amount of Lehman Brothers' Repo 105 transactions or the  
8 company's reliance thereon.

9 163. In addition to signing and authorizing the issuance of materially misleading financial  
10 statements, Callan also made materially misleading statements during Lehman Brothers' earnings  
11 calls for the first and second quarter of 2008. During the March 18, 2008 earnings call, Callan  
12 reported to analysts a drop in Lehman Brothers' net leverage ratio from the fourth quarter 2007 to  
13 the first quarter 2008, but did not disclose that the reduction in leverage was partially attributable to  
14 an approximately \$11 billion increase in quarter-end Repo usage between fourth quarter 2007 and  
15 first quarter 2008. Although specifically asked about the means by which Lehman Brothers  
16 deleveraged, Callan failed to disclose the company's use of off-balance sheet repo transactions to  
17 manage the balance sheet and improve net leverage.

18 164. During the preliminary second quarter 2008 earnings call, Callan focused on Lehman  
19 Brothers' reduced leverage but failed to mention that Lehman Brothers had temporarily removed \$50  
20 billion in assets from its balance sheet using Repo transactions. In addition, at the end of the second  
21 quarter of 2008, Lehman Brothers proclaimed, based on its reported numbers, that it had its "lowest  
22 net leverage ratio in its history as a public company," and that it had reduced the net assets on its  
23 balance sheet by \$60 billion, and that it had a strong and robust liquidity pool. Fuld stated that  
24 Lehman Brothers' capital position had "never been stronger," again without disclosure of the Repo  
25 105 transactions, which created a materially misleading financial picture.

26 165. On or about the same time, there was also widespread public comment in the financial  
27 industry that Lehman Brothers was manipulating its numbers well prior to the closing of the 2008  
28 Swap. Most prominent was David Einhorn, a highly respected hedge fund manager who ran and

1 founded a \$6 billion hedge fund called Greenlight Capital, who began speaking out against Lehman  
2 Brothers' accounting practices as early as November 2007 and accused Lehman Brothers of hiding  
3 multi-billion dollar losses and proclaimed that Lehman had vastly overvalued assets and  
4 underreported its problems. In April 2008, Einhorn had announced that he was shorting Lehman  
5 Brothers based on these beliefs. At the May 21, 2008 Ira W. Sohn Investment Research Conference,  
6 Einhorn gave a speech noting that for levered entities such as Lehman Brothers, "the incentive to  
7 fudge is greater," decried "dishonest public disclosures and outright lies by unscrupulous corporate  
8 managements," and that "there was no reasonable explanation" how Lehman Brothers' publicly  
9 reported numbers could move as they did. Criticizing Callan's March 18, 2008 earnings call,  
10 Einhorn stated: "She used the word 'incredibly' 8 times. I would use 'incredible' in a different way  
11 to describe the report." And after analyzing Lehman Brothers' public financials and Callan's  
12 inability to support them, Einhorn commented: "For the last several weeks, Lehman has been  
13 complaining about short-sellers. Academic research and our experience indicate that when  
14 management teams do that, it is a sign that management is attempting to distract investors from  
15 serious problems. I think there is enough evidence to show how Lehman answered the difficult  
16 question as to whether to tell the truth or suffer the consequences." Einhorn's claim that Lehman  
17 was "fudging" its financials was widely discussed in financial circles, such that the Individual  
18 Lehman Defendants were aware of Einhorn's accusations. In fact, Callan communicated directly  
19 with Einhorn on or about May 20, 2008 regarding Einhorn's concerns about the veracity of  
20 statements made by Callan and Lehman Brothers and Callan's inability to explain Lehman Brothers'  
21 10-Q and stated his belief that Lehman Brothers "is doing an enormous disservice to our financial  
22 markets." Einhorn specifically shared his belief that Lehman Brothers' crisis management "mostly  
23 means denying the reality of [Lehman Brothers'] balance sheet and calling for investigations of  
24 short-sellers who have the temerity to think for themselves."

25 166. In May 2008, a whistleblower within Lehman Brothers, Senior Vice President  
26 Matthew Lee, sent a letter to Lehman Brothers senior management, including Callan and O'Meara,  
27 discussing how the company was committing violations relating to balance sheets and accounting  
28 ("the Lee Letter"). Noting that the company's Code of Ethics stated that "it is critically important

1 that financial statements and related disclosures be free of material errors,” Lee reported, among  
2 other things, that “senior management is not in sufficient control of [Lehman Brothers] assets to be  
3 able to establish that its financial statements are presented to the public and governmental agencies  
4 in a ‘full, fair accurate and timely manner,’” the existence of tens of billions of dollars of  
5 “unsubstantiated balances,” and “senior level internal audit personnel do not have the professional  
6 expertise to properly exercise the audit functions they are entrusted to manage.” In a resulting  
7 internal investigation by Lehman Brothers’ management, Lee specifically raised concerns about  
8 Lehman Brothers’ Repo 105 practice, including Lehman Brothers’ removal of \$50 billion of  
9 inventory off its balance sheet through Repo 105 transactions at the end of the second quarter of  
10 2008.

11 167. On or about June 4, 2008, the Lee Letter was expressly discussed with Cruikshank,  
12 the chairman of Lehman Brothers’ Audit Committee, who asked for a full and thorough investigation  
13 into Lee’s concerns. At a Board of Directors meeting dated June 19, 2008, which Fuld, O’Meara,  
14 Ainslie, Akers, Berlind, Cruikshank, Evans, Gent, Hernandez, Kaufman, and Macomber attended,  
15 Cruikshank reported on the questions raised in the Lee Letter. In advance of the Audit Committee  
16 Meeting dated July 22, 2008, Cruikshank, Ainslie, Berlind, Gent and Fuld received a “Presentation  
17 to the Audit Committee Employment Letter Review” which further discussed the Lee Letter and  
18 Lehman Brothers’ subsequent investigation related thereto.

19 168. On Plaintiffs’ information and belief, despite the public and internal commentary and  
20 that Lehman Brothers was manipulating its numbers, neither Cruikshank nor any other member of  
21 the Audit Committee or the Director Defendants engaged in an independent investigation into the  
22 accusations of the Lee Letter, nor did they publicly disclose, or privately disclose to Plaintiffs, the  
23 truth about Lehman Brothers’ financial condition, i.e., that contrary to their public financial  
24 statements, Lehman Brothers was insolvent.

25 169. On Plaintiffs’ information and belief, even though Lee expressly questioned the  
26 competency of senior management “to establish that its financial statements are presented to the  
27 public and governmental agencies in a ‘full, fair accurate and timely manner,’” none of the Directors,  
28 who had access to company documents and employees, independently reviewed and audited Lehman

1 Brothers' financial statements for their accuracy and/or adequately responded or disclosed those  
2 statements' material misrepresentations regarding Lehman Brothers' financial condition. Rather,  
3 the Director Defendants authorized and signed Lehman Brothers' second quarter 2008 Form 10-Q,  
4 which removed \$50 billion in assets from its balance sheet using Repo 105 transactions, without  
5 sufficient inquiry.

6 170. The Individual Lehman Defendants had an obligation to disclose the Repo 105  
7 practice in Lehman Brothers' periodic reports, and in other public statements and to correct the false  
8 picture presented to counterparties (including Plaintiffs) who had detrimentally and justifiably relied  
9 on them. But, the Individual Lehman Defendants took no action to ensure Lehman Brothers  
10 presented accurate and complete financial statements, periodic reports, and other public statements  
11 or to correct their prior misrepresentations. Indeed, on Plaintiffs' information and belief, the  
12 Individual Lehman Defendants knowingly, and in bad faith caused Lehman Brothers to publicly file  
13 and present reports and statements that contained material omissions and/or misrepresentations,  
14 and/or intentionally refused to disclose the truth regarding prior false and misleading statements of  
15 solvency to Plaintiffs and/or any other counterparties or third parties who had detrimentally and  
16 justifiably relied on them.

17 171. In addition to the material omissions and active concealment, on Plaintiffs'  
18 information and belief, among other things, the Individual Lehman Defendants affirmatively  
19 misrepresented Lehman Brothers' accounting treatment for repos by stating that Lehman Brothers  
20 treated repo transactions as secured financing transactions rather than sales for financial reporting  
21 purposes, despite the fact that Lehman Brothers treated its tens of billions of dollars of Repo 105  
22 transactions as true sale transactions.

23 172. On Plaintiffs' information and belief, the Individual Lehman Defendants were  
24 knowledgeable of and directed, authorized, and/or ratified Lehman Brothers' use of the Repo 105  
25 transactions and the filing of materially misleading financial statements, which contained no mention  
26 that Lehman Brothers engaged in the Repo 105 transactions.

27 173. The net leverage ratios, among other things, which Lehman Brothers reported in its  
28 public filings were misleading and in fact false. Even a sophisticated reader of Lehman Brothers'



1 2007 Annual Report, Forms 10-K and 10-Q would not have been able to ascertain the amount of  
2 Lehman Brothers' Repo 105 usage, nor even ascertain the fact that Lehman was engaged in these  
3 transactions. The Form 10-K and 10-Q reports were authorized and filed by the Individual Lehman  
4 Defendants with the intention and knowledge that they would be disseminated to the public,  
5 including Plaintiffs and others in California, to maintain Lehman Brothers' image in the global  
6 marketplace that it was open for business as usual despite the subprime mortgage crisis, that it  
7 remained a leader in the financial markets, and that it was financially and adequately capitalized and  
8 solvent. Each of the Individual Lehman Defendants also knew and specifically acknowledged in the  
9 2007 Annual Report which they authorized that Lehman Brothers' credit ratings were based on its  
10 public financial information, including the leverage ratios, and that a reduction in Lehman Brothers'  
11 credit ratings would, among other things, trigger provisions under standard provisions in Lehman  
12 Brothers' contracts like the 1998 Swap that would permit counterparties like Plaintiffs to terminate  
13 or require Lehman Brothers to post significant additional collateral.

14 **D. Lehman Brothers Files Bankruptcy**

15 174. As late as September 10, 2008, Lehman Brothers was continuing to report that it was  
16 solvent, and valued its shareholder equity at \$28 billion. In reality, Lehman Brothers was in a deep  
17 capital hole, and had, among other things, continually grossly overvalued its real estate holdings by  
18 \$60 to 70 billion to conceal its lack of equity.

19 175. On September 15, 2008, just seven months after Fuld signed the Annual Report  
20 stating Lehman Brothers had "effectively managed our risk, balance sheet, and expenses" and was  
21 "able to withstand the stresses of rapid shifts in the world liquidity flows," and only five days after  
22 again reporting it was solvent, Lehman Brothers filed Chapter 11 bankruptcy.

23 176. After it filed bankruptcy, Lehman Brothers failed to make payments or in any manner  
24 meet its obligations under the 2008 Swap which had been signed just three months earlier. To avoid  
25 defaulting on the refinanced bonds, Plaintiffs made interest payments to its bond holders without any  
26 protection afforded under the 2008 Swap.

27 177. Prior to and at the time Plaintiffs renegotiated the 2008 Swap and Lehman Brothers  
28 unconditionally guaranteed Plaintiffs' variable interest and capital payment obligations on the

1 refinanced bonds that were subject to the agreement, Lehman Brothers' officers and directors were  
2 aware of materially adverse facts concerning its leverage, liquidity, mortgage-backed asset portfolio  
3 and the mortgage markets in general. Despite such knowledge, Lehman Brothers' officers and  
4 directors failed to take the necessary steps to lower Lehman Brothers' exposure or to disclose the  
5 risks to its customers and clients, including Plaintiffs. Each of the public statements alleged above,  
6 and the concealment of materially adverse facts about Lehman Brothers' financial condition, were  
7 done with the knowledge and approval of the Individual Lehman Defendants, and Lehman Brothers  
8 and its subsidiaries operated in this manner under their direction and authority. Further, such  
9 statements and concealment were directed at California entities, from which Lehman Brothers  
10 derived a substantial portion of its business.

11 **E. Plaintiffs Justifiably Relied on the Individual Lehman Defendants' False**  
12 **Representations, Misleading Statements and Fraudulent Concealment of**  
13 **Lehman Brothers' Financial Condition.**

14 178. Plaintiffs justifiably relied repeatedly and through multiple sources on Lehman  
15 Brothers' false, deceptive and misleading statements that it continued to be a strong, solvent, and  
16 viable company, that it was adequately capitalized, and that it was honestly and fairly reporting to  
17 the public and to Plaintiffs its financial condition. If Lehman Brothers had not made such  
18 statements, which were directed, authorized, and/or approved by each of the Individual Lehman  
19 Defendants, and if Lehman Brothers had not concealed that it lacked liquidity and was grossly  
20 over-leveraged, grossly overexposed to toxic subprime mortgage-backed securities and overpriced  
21 real-estate investments, had engaged in deceptive accounting manipulations to conceal its true  
22 financial condition, and was teetering on the edge of bankruptcy, Plaintiffs would not have entered  
23 into the 2008 Swap, a contract that was supposed to provide years of protection and stability, but  
24 instead cost Plaintiffs enormous fees and created great, ongoing hazard, with no resulting benefit.

25 179. Specifically, Laverne Joseph, President and CEO of Retirement Housing Foundation  
26 together with Frank Rossello, its then Controller and co-CFO, and Brian Magnone, its then Director  
27 of Treasury and co-CFO, relied on multiple misrepresentations, misleading statements and active  
28 concealment by Lehman Brothers throughout 2007 and 2008, including but not limited to false

1 statements and fraudulent non-disclosures in its financial statements. These misrepresentations and  
2 fraudulent concealments relied on by Joseph, Rossello and Magnone came both directly from  
3 Lehman Brothers personnel as well as indirectly from Lehman Brothers through third party advisers  
4 retained or consulted by Plaintiffs who were tasked with reviewing Lehman Brothers' financial  
5 statements. The misrepresentations, misleading statements, and fraudulent non-disclosures relating  
6 to Lehman Brothers' financial condition were both oral and in writing and were made both directly  
7 and indirectly to Plaintiffs and also to their retained representatives (including, attorneys Ursula  
8 Hyman and Carlos Alvarez of Latham & Watkins and investment bankers Mary Munoz and Scott  
9 Determan of Ziegler Securities, Michael Tedesco of Merrill Lynch, John Kayser of BlackRock and  
10 representatives of Cain Brothers including Scott Smith and Joanna Manthei). In addition, Plaintiffs  
11 relied on bankers who provided a line of credit for the 2008 transaction, including but not limited  
12 to lead bank KBC (Barbara Readick, its representative) and participant banks including but not  
13 limited to Bank of the West, U.S. Bank, Comerica Bank, and Sovereign Bank. These banks, before  
14 agreeing to a letter of credit, had to approve the 2008 Swap. Each of these financial institutions had  
15 direct access to Lehman Brothers' financial information and the expertise to evaluate it and did  
16 review and evaluate Lehman Brothers' false financial information, and based thereon informed  
17 Magnone that Lehman Brothers, based on its financials, was strong and viable and thus approved  
18 the 2008 Swap. The Banks' research, review and approval was another reason Joseph, Rossello and  
19 Magnone justifiably believed and relied on Lehman Brothers' false representation of its financial  
20 condition, since had it been truly reported, these banks would not have approved the 2008 Swap.

21 180. In addition to direct misrepresentations to Plaintiffs, the public false, deceptive and  
22 misleading financial statements that were signed and ratified by the Individual Lehman Defendants  
23 and the aforementioned public statements of Fuld, O'Meara, and Callan also constituted an indirect  
24 fraud, such that the rating agencies did not sufficiently downgrade Lehman Brothers and analysts and  
25 public commentators were also fooled and did not report Lehman Brothers had failed or was about  
26 to fail. Joseph, Rossello and Magnone and their third party advisers also repeatedly relied on  
27 information from public rating agencies and analysts who routinely reviewed Lehman Brothers'  
28 financials and either publicly rated or otherwise commented on Lehman Brothers' financial

1 condition. Brian Magnone in particular regularly followed any information about Lehman Brothers'  
2 financial strength, and was thus misled by the reports issued by Lehman Brothers. Because of those  
3 many and continued misrepresentations deceptions and concealments, Plaintiffs did not exercise  
4 rights under the 1998 Swap, but rather entered into the unfair and burdensome 2008 Swap on or  
5 about July 3, 2008.

6 181. Even more specifically, on June 20, 2008, Greg Shlionsky, Senior Vice President  
7 Municipal Derivatives of Lehman Brothers, participated in a phone call with Brian Magnone to  
8 finalize the 2008 Swap. At no time did Mr. Schlionsky ever inform Mr. Magnone that Lehman  
9 Brothers' financials were false, deceptive, and misleading, that its balance sheet had been  
10 manipulated by use of Repo 105, or that its public rating was based on false financials. In addition,  
11 the language of the 2008 Swap had been the subject of negotiation between Plaintiffs and their  
12 representatives (Ziegler and Latham) on the one hand and Lehman Brothers and its representatives  
13 on the other hand on multiple occasions throughout April, May, and June of 2008, and at no time  
14 did Mr. Schlionsky or any other Lehman Brothers representative ever inform any representative of  
15 Plaintiffs that Lehman Brothers' financials were deceptive, misleading or false in any way or that  
16 Lehman Brothers was actually insolvent or becoming insolvent. To the contrary, affirmations of  
17 Lehman Brothers' financial strength and stability were made by reference to Lehman Brothers'  
18 public financial statements repeatedly in those meetings and the exchange of documents of drafts and  
19 documents between the sides, which culminated in the 2008 Swap, which stated in part as follows:

20 **3. Representations**

21 Each party represents to the other party (which representations will be deemed to be  
22 repeated by each party on each date on which a Transaction is entered into) that:

23 \* \* \*

24 (b) **Absence of Certain Events.** No Event of Default or Potential Event of  
25 Default or, to its knowledge, Termination Event with respect to it has occurred and  
26 is continuing and no such event or circumstance would occur as a result of its  
27 entering into or performing its obligations under this Agreement of any Credit  
28 Support Document.

1 \* \* \*

2 (d) **Accuracy of Specified Information.** All applicable information that is  
3 furnished in writing on or on behalf of it to the other party and is identified for the  
4 purpose of this Section 3(d) in the Schedule is, as of the date of the information, true,  
5 accurate and complete in every material respect.

6 Lehman Brothers' "annual report" – which contained the false, deceptive, and misleading financial  
7 information referenced above and was signed, ratified and/or authorized by the Individual Lehman  
8 Defendants, was expressly listed in the 2008 Swap Schedule as "Covered by Section 3(d)." Thus,  
9 in writing in the final 2008 Swap and all its drafts, Lehman Brothers expressly and directly  
10 represented to all the aforementioned representatives of Plaintiffs, all of whom reviewed these  
11 provisions of the 2008 Swap on multiple occasions and relied on the above representations before  
12 the 2008 Swap was signed by Laverne Joseph and Deborah Stouff both on and before July 2, 2008,  
13 that the financial information, including the balance sheet, in Lehman Brothers' annual report was  
14 true, accurate and complete in every material respect.

15 182. In addition, Lehman Brothers' true financial condition constituted an "Event of  
16 Default or Potential Event of Default" as well as a "Termination Event," so 3(b) also was a false  
17 representation and fraudulent concealment which Joseph, Rossello and Magnone read and relied on  
18 in July of 2008 before signing the 2008 Swap. Lehman Brothers' insolvency or potential insolvency  
19 is an express Event of Default or Potential Event of Default, and was also a Termination Event under  
20 both the 1998 Swap and the 2008 Swap. Indeed, per both swaps, if Lehman Brothers' public rating  
21 falls below BBB- by S&P and Baa3 by Moody's Investor Service, Inc., Plaintiffs had a right to  
22 terminate the swap with Lehman Brothers as the defaulting party. If the true nature of Lehman  
23 Brothers' financial condition had been revealed, Lehman Brothers would have been either actually  
24 insolvent or potentially insolvent and also fallen below the two contractual ratings requirements,  
25 which were negotiated terms in both the 1998 Swap and the 2008 Swap. Thus, Plaintiffs also were  
26 aware of Lehman Brothers' public ratings and relied thereon to their detriment. Had Lehman  
27 Brothers supplied true and correct financials with no Repo 105 or other misrepresentations, Lehman  
28 Brothers' ratings would have fallen below the levels required by both the 1998 Swap and the 2008

1 Swap, and Plaintiffs never would have signed the 2008 Swap, but instead placed Lehman Brothers  
2 in default under the 1998 Swap.

3 183. The above quoted written direct material representations constitute standard language  
4 in the ISDA Master Agreement form, so that the Individual Lehman Defendants knew that Lehman  
5 Brothers' financials were to be represented as "true, accurate and complete in every material respect"  
6 to every and any counterparty with whom Lehman Brothers entered into a swap.

7 184. Moreover, pursuant to Paragraph 4(a) and the attached Schedule of the 1998 Swap,  
8 Lehman Brothers had a continuing duty to provide Plaintiffs "as soon as reasonably practicable" its  
9 financial documents, including its "most recent publicly available annual report," "unaudited  
10 consolidated financial statements," and "each regular financial or business reporting document that  
11 is distributed or made generally available," all of which were reaffirmed as "true, accurate and  
12 complete in every material respect." This standard language in all ISDA contracts of the continuing  
13 obligation to provide documents was known to the Individual Lehman Defendants, and thus when  
14 they approved, signed and ratified the false and misleading financials of Lehman Brothers, they knew  
15 that they had a duty to provide truthful and complete financials and that counterparties such as  
16 Plaintiffs would rely on these financials. But the Individual Lehman Defendants knew that truthful  
17 financial statements would put them in default under their obligations to counterparties, as falling  
18 under a BBB- S&P rating or a Baa3 Moody's rating constituted both an Event of Default by Lehman  
19 Brothers and a Termination Event, giving Plaintiffs substantial rights.

20 185. Specific instances of reliance by Plaintiffs in signing the 2008 Swap and not  
21 exercising rights under the 1998 Swap include but are not limited to the following:

22 a. Written representations in Lehman Brothers' 2007 Annual Report (including  
23 but not limited to Exhibit I), which was directly reviewed and justifiably relied on by Brian  
24 Magnone in or about April and May of 2008, which reported Lehman Brothers' Financial  
25 Highlights, showing upward trends in net revenue, total assets and long-term capital and  
26 reported the Firm's net leverage ratio, among other financial statistics referencing Lehman  
27 Brothers' positive financial condition, and which was signed by Defendant Fuld and  
28 authorized and approved by all of the other Individual Lehman Defendants;

1           b.       Written representations that the Individual Lehman Defendants knew were  
2 in Lehman Brothers' contracts and which were read and relied on by Joseph, Rossello, and  
3 Magnone on or about July 3, 2008; these statements were contained within the 2008 Swap  
4 at Sections 3 and 4 together with the attached Schedule at (g) (ii) (regarding Lehman  
5 Brothers' credit rating) and also in Part 2 which designated Documents from Lehman  
6 Brothers (specifically including its 2007 Annual Report) as true, accurate and complete in  
7 every material respect;

8           c.       Direct oral misrepresentations, misleading statements and concealments from  
9 Lehman Brothers personnel regarding Lehman Brothers' financial information, which the  
10 Individual Lehman Defendants knew would occur based on their false financials, directly to  
11 Brian Magnone including but not limited to the following:

12               (1)     Greg Shlionsky's June 20, 2008 oral statements and representations  
13 to Brian Magnone on their telephonic conference setting the 2008 Swap terms and  
14 the 1998 Swap valuations, that Lehman Brothers was not in default and had rights  
15 entitling it to \$13 million under the 1998 Swap, but failing to disclose that Lehman  
16 Brothers in fact was in default and insolvent and that its credit rating was based on  
17 false financials;

18               (2)     Statements to Brian Magnone by Lehman Brothers representatives on  
19 April 16, 2008 on a telephonic conference call negotiating 2008 Swap terms and  
20 ACA issues and failing to acknowledge Lehman Brothers was in default, but  
21 requiring a gross revenue pledge from Plaintiffs which would not have been required  
22 if Lehman Brothers' financials as reflected in its 2007 Annual report and its 2007  
23 10K and 2008 10Qs had been true and accurate;

24               (3)     Senior Vice President of Municipal Derivatives of Lehman Brothers  
25 Corey Long's December 14, 2007 telephonic communication to Brian Magnone  
26 regarding Lehman Brothers' position regarding the refinancing of the 1998 Swap,  
27 which rejected a proposed restructure from Magnone and failed to acknowledge that  
28 due to the true financial condition of Lehman Brothers, Lehman Brothers was in

1 default and could not take such a position;

2 (4) Corey Long's November 13 and 15, 2007 telephonic communications  
3 to Brian Magnone that the 1998 swap was not in default and that Lehman Brothers  
4 continued to be in control, so Plaintiffs had no rights to terminate without a  
5 substantial multi-million dollar payment to Lehman Brothers and otherwise had to  
6 keep the 1998 swap in place, without disclosing the true facts, that Lehman Brothers  
7 was falsifying its financials through the use of Repo 105, amongst other things, and  
8 was in fact in default and subject to at termination event;

9 (5) Huberto Gutierrez of Lehman High Yield Trading's telephonic  
10 communication on July 26, 2007 to Brian Magnone, that Lehman Brothers continued  
11 to be sound and solvent.

12 d. Written and oral representations by Lehman Brothers representatives  
13 McDermott Will & Emory and Lehman Brothers employees during negotiations of the 2008  
14 Swap documentation that continuously transmitted the drafts containing false representations  
15 about the truth and completeness of Lehman Brothers' financials, that Lehman Brothers'  
16 public rating was true and correct and based on accurate and complete information, and that  
17 Lehman Brothers was not in default under the 1998 Swap, including but not limited to:  
18 written transmissions of drafts of the 2008 Swap repeating these representations and those  
19 referenced above on June 13, 2008, June 18, 2008, June 19, 2008 (twice), June 20, 2008  
20 (twice), June 25, 2008, June 27, 2008 and June 30, 2008 from Douglas Youngman to  
21 representatives of the RHF Group, including Carlos Alvarez and Ursula Hyman of Latham  
22 & Watkins and Scott Determan and Tom Costello of Ziegler;

23 e. Kathleen Kalaher's email on June 25, 2008 to Hyman and Costello, reviewed  
24 by Magnone, affirming that Lehman Brothers would execute the ISDA agreement  
25 constituting the 2008 Swap, which contained the false and misleading representations about  
26 Lehman Brothers' finances;

27 f. Oral representations in June or July of 2008 by "top Lehman management"  
28 to "top management at BlackRock" that Lehman Brothers was financially sound, which were



1 reported to Magnone in July 2008 by Plaintiffs' advisers John Kayser and Michael Tedesco  
2 and before July by Tedesco;

3 g. Representations by the Individual Lehman Defendants described above that  
4 (on information and belief) were reviewed and in fact were repeated on September 25, 2007  
5 and continuing on October 1, 2007 by Scott Smith of Cain Brothers to Brian Magnone that  
6 Lehman Brothers was sound and maintained its A rating, so that as a result no collateral  
7 needed to be posted by Lehman Brothers; this advice was based on Cain Brothers'  
8 investigation and review regarding Lehman Brothers' financial condition and representations  
9 that was specifically instigated by inquiries about the 1998 Swap by Magnone who relied on  
10 Cain Brothers to directly review Lehman Brothers' financial information at that time; on  
11 information and belief, Cain Brothers, then the RHF Group's swap adviser, regularly  
12 reviewed and was aware of public information disseminated by Lehman Brothers about its  
13 financial condition through Annual Reports, 10Ks and/or 10Qs, and Cain Brothers never  
14 reported that Lehman Brothers was insolvent or had false financials or that the RHF Group  
15 had termination rights while acting as the RHF Group's monitoring agent, structuring agent,  
16 and swap adviser and advising the RHF Group on its rights under the 1998 Swap;

17 h. Multiple oral and written recommendations, statements and representations  
18 during the twelve months prior to signing the 2008 Swap and particularly in June and July  
19 of 2008 to Brian Magnone and Frank Rossello by Mary Munoz, Scott Determan, John Kautz,  
20 Aaron Schroeder, and John Costello as well as others at Ziegler, the RHF Group's swap  
21 adviser and representative for the 2008 Swap, who negotiated the 2008 Swap and advised  
22 Plaintiffs to enter into it based, among other things, on their expertise and knowledge of  
23 Lehman Brothers' public financial information (from Annual Reports, 10Ks and/or 10 Qs)  
24 and public statements on conference calls by Fuld, Callan, and O'Meara; Ziegler, a  
25 sophisticated investment banking firm, who specializes in identifying, analyzing, defining,  
26 measuring, and then mitigating financial risk, reviewed and/or was aware of Lehman  
27 Brothers' credit rating and public statements about its financial condition and would never  
28 have advised Plaintiffs to enter into the 2008 Swap with Lehman Brothers or negotiated its

1 terms as it did had Ziegler not been convinced by the public information disseminated  
2 through Lehman Brothers' 2007 Annual Report, 2007 10K, and 2007 and/or 2008 10Qs that  
3 Lehman Brothers was financially strong, solvent, and an appropriate swap counterparty for  
4 a 20 year commitment involving \$100 million;

5 i. Indirectly from the Individual Lehman Defendants, oral and written  
6 representations to Brian Magnone in May, June and July of 2008 by the RHF Group banks,  
7 including Bank of the West's Astrid Kramarz, Bank of America's Charmaine Atherton and  
8 Barbara Readick of KBC Bank, based on their respective bank's review of the Individual  
9 Lehman Defendants' statements about Lehman Brothers' public financials, so that Kramarz,  
10 Atherton and Readick informed Plaintiffs that the banks approved Plaintiffs signing the 2008  
11 Swap based on Lehman Brothers' representations that it was a solvent and reliable swap  
12 counterparty;

13 j. Indirect oral and written representations by each of the Individual Lehman  
14 Defendants described above about Lehman Brothers' financial condition to the Standard &  
15 Poor's and Moody's rating agencies, which were then repeated to all the Plaintiffs  
16 representatives referenced above by the rating agencies in their public ratings of Lehman  
17 Brothers, which were directly then included in the drafting of the ratings requirements in the  
18 2008 Swap.

19 **FIRST CAUSE OF ACTION**

20 **(Negligence By All Plaintiffs Against Cain Brothers and Does 1-10)**

21 186. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
22 Complaint as though set forth in full at this point.

23 187. Cain Brothers, as the RHF Group's investment banker and financial advisor in  
24 connection with the Financial Advisory Agreement, had a duty to exercise reasonable care in the  
25 rendition of financial services to Plaintiffs, which included a duty to properly structure the  
26 transaction and to disclose to Plaintiffs all material facts regarding the 1998 plan of refinancing.

27 188. On Plaintiffs' information and belief, Cain Brothers negligently failed to exercise  
28 reasonable care in the rendition of financial services to Plaintiffs by, among other things, designing

1 a risky and flawed plan of refinancing and failing to adequately disclose the defects in the plan,  
2 including Lehman Brothers' unfair valuation methodology with respect to the Swap Contract;  
3 Lehman Brothers' unfair SAVRS auction practices; the RHF Group's inability to cure the effects of  
4 ACA's downgrade; the RHF Group's inability to exit the "alternative floating rate" provision under  
5 the Swap Contract and Lehman Brothers' concurrent ability to manipulate the SAVRS auctions to  
6 its benefit and the RHF Group's detriment; and ACA's risky business practices and mismanagement.

7 189. As a proximate result of Cain Brothers' negligence, Plaintiffs have suffered and will  
8 continue to suffer general and special damages in the form of, among other things, lost benefits under  
9 their Financial Advisory Agreement with Cain Brothers, costs incurred re-funding the SAVRS and  
10 bonds that were issued for the benefit of the RHF Group, St. Catherine and DeSmet, and liability,  
11 losses and expenses under the Swap Contracts and on the SAVRS, the exact amount of which will  
12 be proven at trial, but in excess of \$20,000,000.

13 **SECOND CAUSE OF ACTION**

14 **(Negligent Misrepresentation By All Plaintiffs Against Cain Brothers and Does 1-10)**

15 190. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
16 Complaint as though set forth in full at this point.

17 191. On Plaintiffs' information and belief, prior to and at the time the Financial Advisory  
18 Agreement, the Swap Contract and the Insurance Agreement were executed in or about the latter half  
19 of 1998, Cain Brothers, through its representatives Joan Annett (a Senior Vice President) and Scott  
20 Smith (a Managing Director), made and assumed the above-described written and oral  
21 representations regarding, among other things, that the 1998 plan of refinancing would be designed  
22 in a safe and reasonable manner, that the 1998 plan of refinancing presented a safe alternative to  
23 more traditional and more expensive fixed rate bonds and would decrease the cost of any future  
24 refinancing by the RHF Group, and that the "Dutch" auctions held by Lehman Brothers every 35  
25 days would provide a fair market interest rate on the SAVRS. On Plaintiffs' information and belief,  
26 prior to and at the time the Financial Advisory Agreement, the Swap Contract and the Insurance  
27 Agreement were executed in or about the latter half of 1998, Cain Brothers, through its  
28 representatives Joan Annett and Scott Smith, made and assumed the above-described written and

1 oral representations regarding, among other things, that ACA engaged in responsible business  
2 practices and financial conservatism consistent with its preferred investment grade “A” rating, and  
3 that the use of ACA as an insurer and the structure of the insurance as it related to the refinancing  
4 as a whole minimized risk and provided flexibility.

5 192. However, on Plaintiffs’ information and belief, at the time these written and oral  
6 promises and representations were made, they were in fact false.

7 193. When Cain Brothers made the above-described representations, it had no reasonable  
8 ground for believing them to be true, and made the representations with the intention of inducing the  
9 RHF Group to act in reliance on them and enter into the Financial Advisory Agreement, the Swap  
10 Contract, the Insurance Agreement, other contracts associated with the Official Statement Dated as  
11 of December 7, 1998, and to issue SAVRS, and further to issue additional bonds for the benefit of  
12 St. Catherine and DeSmet that were also subject to interest rate swaps with Lehman Brothers.

13 194. Plaintiffs, at the time the above-described representations were made by Cain  
14 Brothers, were ignorant of the falsity of Cain Brothers’ representations and reasonably believed them  
15 to be true. In justifiable reliance on these representations, Plaintiffs, among other things, entered into  
16 a Financial Advisory Agreement with Cain Brothers, the Swap Contract with Lehman Brothers, and  
17 the Insurance Agreement with ACA, and issued additional bonds for the benefit of St. Catherine and  
18 DeSmet that were also subject to interest rate swaps with Lehman Brothers.

19 195. As a proximate result of Cain Brothers’ negligent misrepresentations, Plaintiffs have  
20 suffered and will continue to suffer general and special damages in the form of, among other things,  
21 lost benefits under their Financial Advisory Agreement with Cain Brothers, costs incurred re-funding  
22 the SAVRS and bonds that were issued for the benefit of the RHF Group, St. Catherine and DeSmet,  
23 and liability, losses and expenses under the Swap Contracts and on the SAVRS, the exact amount  
24 of which will be proven at trial, but in excess of \$20,000,000.

### 25 **THIRD CAUSE OF ACTION**

#### 26 **(Breach of Fiduciary Duty By All Plaintiffs Against Cain Brothers and Does 1-10)**

27 196. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
28 Complaint as though set forth in full at this point.

1           197. By virtue of the investment banking and financial advisor relationship that existed  
2 between Cain Brothers and Plaintiffs, Cain Brothers owed to Plaintiffs a fiduciary duty, and by virtue  
3 of Plaintiffs having placed confidence in the fidelity and integrity of Cain Brothers and in entrusting  
4 Cain Brothers with, among other things, the RHF Group's 1998 plan of refinancing and the issuance  
5 of bonds for the benefit of St. Catherine and DeSmet, a fiduciary relationship existed at all times  
6 relevant to this Sixth Amended Complaint between Cain Brothers and Plaintiffs.

7           198. On Plaintiffs' information and belief, prior to and at the time the Financial Advisory  
8 Agreement, the Swap Contract and the Insurance Agreement were executed in or about the latter half  
9 of 1998, Cain Brothers, through its representatives Joan Annett (a Senior Vice President) and Scott  
10 Smith (a Managing Director), made and assumed the above-described written and oral  
11 representations regarding, among other things, that the 1998 plan of refinancing would be designed  
12 in a safe and reasonable manner, that the 1998 plan of refinancing presented a safe alternative to  
13 more traditional and more expensive fixed rate bonds and would decrease the cost of any future  
14 refinancing by the RHF Group, and that the "Dutch" auctions held by Lehman Brothers every 35  
15 days would provide a fair market interest rate on the SAVRS. On Plaintiffs' information and belief,  
16 prior to and at the time the Financial Advisory Agreement, the Swap Contract and the Insurance  
17 Agreement were executed in or about the latter half of 1998, Cain Brothers, through its  
18 representatives Joan Annett and Scott Smith, made and assumed the above-described written and  
19 oral representations regarding, among other things, that ACA engaged in responsible business  
20 practices and financial conservatism consistent with its preferred investment grade "A" rating, and  
21 that the use of ACA as an insurer and the structure of the insurance as it related to the refinancing  
22 as a whole minimized risk and provided flexibility.

23           199. Despite having voluntarily accepted the trust and confidence of Plaintiffs with regard  
24 to, among other things, the RHF Group's 1998 plan of refinancing and the issuance of bonds for the  
25 benefit of St. Catherine and DeSmet, and in violation of this relationship of trust and confidence,  
26 Cain Brothers abused the trust and confidence of Plaintiffs by, among other things, designing a risky  
27 and flawed plan of refinancing and failing to adequately disclose the defects in the plan, including  
28 Lehman Brothers' unfair valuation methodology with respect to the Swap Contract; Lehman

1 Brothers' unfair SAVRS auction practices; the RHF Group's inability to cure the effects of ACA's  
2 downgrade; the RHF Group's inability to exit the "alternative floating rate" provision under the  
3 Swap Contract and Lehman Brothers' concurrent ability to manipulate the SAVRS auctions to its  
4 benefit and the RHF Group's detriment; and ACA's risky business practices and mismanagement.

5 200. Plaintiffs in fact placed confidence and reliance in Cain Brothers until late 2007 and  
6 early 2008, when Plaintiffs' costs in connection with the SAVRS spiraled out of control and  
7 Plaintiffs re-funded the SAVRS and bonds.

8 201. By failing to make the foregoing disclosures regarding the 1998 plan of refinance,  
9 Cain Brothers breached their fiduciary duties to Plaintiffs.

10 202. As a proximate result of Cain Brothers' breaches of fiduciary duty, Plaintiffs have  
11 suffered and will continue to suffer general and special damages in the form of, among other things,  
12 lost benefits under the Financial Advisory Agreement with Cain Brothers, costs incurred re-funding  
13 the SAVRS and bonds that were issued for the benefit of the RHF Group, St. Catherine and DeSmet,  
14 and liability, losses and expenses under the Swap Contracts and on the SAVRS, the exact amount  
15 of which will be proven at trial, but in excess of \$20,000,000.

16 203. On Plaintiffs' information and belief, Cain Brothers' officers, directors and/or  
17 managing agents acted with fraud, oppression and malice, in that their conduct was despicable and  
18 was carried on with a willful and conscious disregard for the rights of Plaintiffs; and in that their  
19 conduct subjected Plaintiffs to cruel and unjust hardship in conscious disregard of Plaintiffs' rights  
20 or otherwise causing injury to Plaintiffs. On Plaintiffs' information and belief, Cain Brothers had  
21 advance knowledge and authorized and ratified these acts of fraud, oppression and malice performed  
22 by its officers, directors, and/or managing agents. Thus, Plaintiffs are therefore entitled to the  
23 assessment of punitive damages against Cain Brothers in an amount to be proven at trial.

24 **FOURTH CAUSE OF ACTION**

25 **(Constructive Fraud By All Plaintiffs Against Cain Brothers and Does 1-10)**

26 204. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
27 Complaint as though set forth in full at this point.

28 205. Cain Brothers' conduct as alleged herein constituted constructive fraud against

1 Plaintiffs.

2 206. As a proximate result of Cain Brothers' constructive fraud, Plaintiffs have suffered  
3 and will continue to suffer general and special damages in the form of, among other things, lost  
4 benefits under the Financial Advisory Agreement with Cain Brothers, costs incurred re-funding the  
5 SAVRS and bonds that were issued for the benefit of the RHF Group, St. Catherine and DeSmet,  
6 and liability, losses and expenses under the Swap Contracts and on the SAVRS, the exact amount  
7 of which will be proven at trial, but in excess of \$20,000,000.

8 207. On Plaintiffs' information and belief, Cain Brothers' officers, directors and/or  
9 managing agents acted with fraud, oppression and malice, in that their conduct was despicable and  
10 was carried on with a willful and conscious disregard for the rights of Plaintiffs; and in that their  
11 conduct subjected Plaintiffs to cruel and unjust hardship in conscious disregard of Plaintiffs' rights  
12 or otherwise causing injury to Plaintiffs. On Plaintiffs' information and belief, Cain Brothers had  
13 advance knowledge and authorized and ratified these acts of fraud, oppression and malice performed  
14 by its officers, directors, and/or managing agents. Thus, Plaintiffs are therefore entitled to the  
15 assessment of punitive damages against Cain Brothers in an amount to be proven at trial.

16 **FIFTH CAUSE OF ACTION**

17 **(Fraud & Deceit By The RHF Group Against ACA and Does 13-20)**

18 208. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
19 Complaint as though set forth in full at this point.

20 209. On Plaintiffs' information and belief, prior to and at the time the Insurance Agreement  
21 was executed in or about December 1998, ACA made and assumed the above-described  
22 representations regarding, among other things, its purported responsible business practices and  
23 financial conservatism consistent with its preferred investment grade "A" rating and that it would  
24 enhance Plaintiffs' creditworthiness by effectively "guarantee[ing] . . . payment when due of  
25 principal (whether at maturity or by mandatory sinking fund redemption) and interest on the 1998  
26 SAVRS." These representations were made with the intent to induce Plaintiffs to enter into the  
27 Insurance Agreement. However, at the time these promises were made, ACA had no intention of  
28 performing them.

1           210. At the time ACA made these promises, the RHF Group was ignorant of ACA's  
2 hidden intention not to perform these promises. In the exercise of due diligence, the RHF Group  
3 could not have discovered ACA's hidden intention.

4           211. Furthermore, ACA made and assumed the above-described misrepresentations in  
5 2005 regarding its purportedly strong financial position, that it conducted itself in a responsible  
6 manner, that it was financially strong, and that it was sensitive to issues that could trigger a  
7 downgrade. In or about May and/or June 2005, Gilpin continually assured Plaintiffs' representative  
8 Brian Magnone orally and in writing that ACA was stable and would continue to be stable because  
9 ACA was growing its business slowly, and ACA had received sufficient equity capital the previous  
10 year from an investment from Bear Stearns. Gilpin also told Magnone that ACA guaranteed only the  
11 safest, lowest risk AAA-rated tranches that were unaffected by market changes and volatility and that  
12 ACA maintained more than adequate capital to cover any potential loss exposure from CDOs.  
13 Gilpin stressed that ACA's current management team was sensitive to issues that caused ACA's  
14 prior credit issues, including the failure to maintain adequate loss reserves consistent with its "A"  
15 rating, and that ACA's current business model was designed to prevent those issues from arising  
16 again.

17           212. Also in or about May and/or June 2005, Gilpin and Roseman, ACA's CEO and  
18 President, expressly represented orally and in writing to Magnone that ACA had hired a new auditor  
19 and implemented new accounting procedures that were intended to satisfy generally accepted  
20 accounting standards in the CDO industry and would not affect ACA's financial position or  
21 shareholders' equity, and that ACA was financially stable and maintained adequate loss reserves  
22 consistent with its "A" rating.

23           213. As late as August 2007, Gilpin and Roseman orally represented and reaffirmed to  
24 Magnone that ACA was "well capitalized," was "open for business," was "financed to term," that  
25 ACA's A rating from Standard & Poor's would remain intact, that there was "no liquidity issues on  
26 [ACA's exposure] to mark to markets," which were rated "above AA levels of risk" and that ACA's  
27 capital levels were adequate and consistent with its "A" rating.

28           214. However, ACA, Gilpin and Roseman concealed that ACA faced massive risk and



1 held extremely inadequate reserves. On Plaintiffs' information and belief, ACA knew of the falsity  
2 of these representations, due to its massive over-exposure to extremely risky subprime mortgage-  
3 backed securities, but the RHF Group was ignorant of and could not have reasonably discovered  
4 their falsity.

5 215. When ACA made the above-described representations prior to and at the time the  
6 Insurance Agreement was executed in or about December 1998, it had no reasonable ground for  
7 believing them to be true, and made the representations with the intention of inducing the RHF  
8 Group to act in reliance on it and enter into an agreement with ACA regarding bond insurance.

9 216. On Plaintiffs' information and belief, ACA's 2005 misrepresentations and  
10 concealment were made with the intent to deceive Plaintiffs and similarly situated entities and to  
11 induce them to rely on the misrepresentations and concealment so that such entities would not  
12 restructure their debt in a manner that did not rely on ACA.

13 217. In reliance on the 1998 promises made by ACA, the RHF Group entered into an  
14 Insurance Agreement with ACA, and paid a premium based on ACA's irrevocable and unconditional  
15 guarantee to provide interest and capital repayments as specified in the SAVRS, minimize a  
16 perceived risk that the RHF Group would default on those obligations, and maintain the investment  
17 strength of the SAVRS. Furthermore, in reliance on ACA's 2005 misrepresentations and  
18 concealment of its precarious financial situation, the RHF Group did not at that time seek to  
19 restructure its financing so that it would not be reliant on ACA for its "A" rating.

20 218. ACA has now failed and refused, and continues to fail and refuse, to perform the  
21 above-described promises made to the RHF Group.

22 219. As a proximate result of ACA's failure to perform its promises made regarding,  
23 among other things, its responsible business practices and financial conservatism consistent with its  
24 investment grade "A" rating, the RHF Group has suffered and will continue to suffer general and  
25 special damages in the form of, among other things, lost benefits under its Insurance Agreement with  
26 ACA and costs incurred re-funding the SAVRS that were issued for the benefit of the RHF Group  
27 and were formerly insured by ACA, the exact amount of which will be proven at trial, but in excess  
28 of \$20,000,000.



1 SAVRS.” These representations were made with the intent to induce Plaintiffs to enter into the  
2 Insurance Agreement. However, at the time these promises were made, they were in fact false.

3 225. Furthermore, ACA made and assumed the above-described misrepresentations in  
4 2005 regarding its purportedly strong financial position, that it conducted itself in a responsible  
5 manner, that it was financially strong, and that it was sensitive to issues that could trigger a  
6 downgrade. In or about May and/or June 2005, Gilpin continually assured Plaintiffs’ representative  
7 Brian Magnone orally and in writing that ACA was stable and would continue to be stable because  
8 ACA was growing its business slowly, and ACA had received sufficient equity capital the previous  
9 year from an investment from Bear Stearns. Gilpin also told Magnone that ACA guaranteed only the  
10 safest, lowest risk AAA-rated tranches that were unaffected by market changes and volatility and that  
11 ACA maintained more than adequate capital to cover any potential loss exposure from CDOs.  
12 Gilpin stressed that ACA’s current management team was sensitive to issues that caused ACA’s  
13 prior credit issues, including the failure to maintain adequate loss reserves consistent with its “A”  
14 rating, and that ACA’s current business model was designed to prevent those issues from arising  
15 again.

16 226. Also in or about May and/or June 2005, Gilpin and Roseman, ACA’s CEO and  
17 President, expressly represented orally and in writing to Magnone that ACA had hired a new auditor  
18 and implemented new accounting procedures that were intended to satisfy generally accepted  
19 accounting standards in the CDO industry and would not affect ACA’s financial position or  
20 shareholders’ equity, and that ACA was financially stable and maintained adequate loss reserves  
21 consistent with its “A” rating.

22 227. As late as August 2007, Gilpin and Roseman orally represented and reaffirmed to  
23 Magnone that ACA was “well capitalized,” was “open for business,” was “financed to term,” that  
24 ACA’s A rating from Standard & Poor’s would remain intact, that there was “no liquidity issues on  
25 [ACA’s exposure] to mark to markets,” which were rated “above AA levels of risk” and that ACA’s  
26 capital levels were adequate and consistent with its “A” rating.

27 228. When ACA made the above-described representations prior to and at the time the  
28 Insurance Agreement was executed in or about December 1998, it had no reasonable ground for

1 believing them to be true, and made the representations with the intention of inducing the RHF  
2 Group to act in reliance on it and enter into an agreement with ACA regarding bond insurance.

3 229. On Plaintiffs' information and belief, when ACA made the above-described  
4 representations in 2005 it had no reasonable ground for believing them to be true, and made them  
5 with the intent to induce Plaintiffs and similarly situated entities to rely on the representations so that  
6 such entities would not restructure their debt in a manner that did not involve ACA.

7 230. The RHF Group, at the time the above-described representations were made by ACA,  
8 was ignorant of the falsity of ACA's representations and believed them to be true. In justifiable  
9 reliance on these representations, the RHF Group, among other things, entered into an Insurance  
10 Agreement with ACA and, in or around 2005, did not seek to restructure its financing so that it  
11 would not be reliant on ACA for its "A" rating.

12 231. It was not until the time that ACA was downgraded in December 2007 that Plaintiffs  
13 discovered that ACA's prior representations, including that it conducted itself in a responsible  
14 manner and was financially strong, were in fact false.

15 232. As a proximate result of ACA negligent misrepresentations, the RHF Group has  
16 suffered and will continue to suffer general and special damages in the form of, among other things,  
17 lost benefits under its Insurance Agreement with ACA, costs incurred re-funding the SAVRS that  
18 were issued for the benefit of the RHF Group and were formerly insured by ACA, and increased  
19 costs that it otherwise could have saved if it restructured its financing so that it was not reliant on  
20 ACA for its "A" rating, the exact amount of which will be proven at trial, but in excess of  
21 \$20,000,000.

22 **SEVENTH CAUSE OF ACTION**

23 **(Unfair Competition Contrary to Business & Professions Code §17200 et seq.,**

24 **By The RHF Group Against ACA and Does 13-20)**

25 233. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 184 of this Sixth Amended  
26 Complaint as though set forth in full at this point.

27 234. The conduct of ACA as alleged herein constitutes unlawful, unfair and/or fraudulent  
28 business practices and unfair competition with the RHF Group in violation of Sections 17200 et seq.

1 of the California Business & Professions Code.

2 235. In addition, on Plaintiffs' information and belief, ACA has been unjustly enriched as  
3 a direct and proximate result of its actions as alleged herein, and the RHF Group is entitled to  
4 recover such amount that ACA has been unjustly enriched by its unfair actions toward the RHF  
5 Group.

6 **EIGHTH CAUSE OF ACTION**

7 **(Fraud, Deceit, and Conspiracy to Defraud By All Plaintiffs Against**

8 **Fuld, O'Meara and Does 21-30)**

9 236. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
10 Complaint as though set forth in full at this point.

11 237. From approximately December 2007 through June 2008, Lehman Brothers  
12 intentionally made the above-described representations regarding the purported results of the SAVRS  
13 auctions, including how much Plaintiffs purportedly owed. However, on Plaintiffs' information and  
14 belief, at the time these representations were made, they were in fact false, as the purported auction  
15 results were not the results obtained through the proper auction process at all, but instead were based  
16 on inflated rates created by Lehman Brothers' undisclosed and unfair manipulation of the SAVRS  
17 auctions.

18 238. On Plaintiffs' information and belief, Lehman Brothers' made the above-described  
19 misrepresentations regarding the purported SAVRS auctions knowing they were false and with the  
20 intent to deceive Plaintiffs and to induce Plaintiffs to rely on them so that Plaintiffs would pay to  
21 Lehman Brothers amounts pertaining to the SAVRS auctions that far exceeded the amounts that  
22 would have been owed if the auctions were conducted in a fair, proper, and reasonable manner.

23 239. Plaintiffs, at the time the above-described representations were made, were ignorant  
24 of the falsity of the representations and justifiably and reasonably believed them to be true and relied  
25 thereon to their detriment.

26 240. As a proximate result of this fraud and deceit, Plaintiffs have suffered and will  
27 continue to suffer general and special damages in the form of, among other things, unfairly inflated  
28 payments on the SAVRS during the period of approximately December 2007 to June 2008, the exact

1 amount of which will be proven at trial.

2           241. On Plaintiffs' information and belief, Fuld and O'Meara and Does 21 through 30  
3 conspired to defraud and/or had knowledge of and/or directed and/or approved and/or ratified  
4 Lehman Brothers' intentional manipulation of the auctions of the RHF Group's SAVRS, the  
5 intentional transmittals to Plaintiffs of so-called auction results that in fact were based on unfair and  
6 undisclosed manipulation, and the resulting demands for payment. Further, on information and  
7 belief, the Individual Lehman Defendants became aware of the intentional auction manipulations and  
8 attendant misrepresentations and payment demands by Lehman Brothers, and ratified the  
9 continuance of this wrongful course of conduct. Lehman Brothers and its subsidiaries, which it  
10 controlled, operated in this manner under the Individual Lehman Defendants' direction and authority.  
11 Moreover, the Individual Lehman Defendants accepted and retained the benefits of this conduct, as  
12 Plaintiffs' inflated payments increased profits for Lehman Brothers and allowed it to stave off  
13 bankruptcy longer than otherwise possible.

14           242. On Plaintiffs' information and belief, in conspiring, making, directing, approving,  
15 and/or ratifying the above-described fraudulent representations and conduct, Fuld and O'Meara,  
16 acted with fraud, oppression and malice, in that their conduct was despicable and was carried on with  
17 a willful and conscious disregard for the rights of Plaintiffs; and in that their conduct subjected  
18 Plaintiffs to cruel and unjust hardship in conscious disregard of their rights or otherwise causing  
19 injury to Plaintiffs. On Plaintiffs' information and belief, Fuld and O'Meara had advance knowledge  
20 and authorized and ratified these acts of fraud, oppression and malice performed by themselves.  
21 Thus, Plaintiffs are therefore entitled to the assessment of punitive damages against Fuld and  
22 O'Meara in an amount to be proven at trial.

23                                   **NINTH CAUSE OF ACTION**

24                                   **(Negligent Misrepresentation By All Plaintiffs Against**

25                                   **Fuld and O'Meara and Does 21-30)**

26           243. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
27 Complaint as though set forth in full at this point.

28           244. From approximately December 2007 through June 2008, Lehman Brothers made the

1 above-described representations regarding the purported results of the SAVRS auctions, including  
2 how much Plaintiffs purportedly owed. However, on Plaintiffs' information and belief, at the time  
3 these representations were made, they were in fact false and Lehman Brothers had no reason to  
4 believe they were true, as the purported auction results were not the results obtained through the  
5 proper auction process at all, but instead were based on inflated rates created by Lehman Brothers'  
6 undisclosed and unfair manipulation of the SAVRS auctions.

7 245. On Plaintiffs' information and belief, Lehman Brothers' made the above-described  
8 misrepresentations regarding the purported SAVRS auctions with the intent to induce Plaintiffs to  
9 rely on them so that Plaintiffs would pay to Lehman Brothers amounts pertaining to the SAVRS  
10 auctions that far exceeded the amounts that would have been owed if the auctions were conducted  
11 in a fair, proper, and reasonable manner.

12 246. Plaintiffs, at the time the above-described representations were made, were ignorant  
13 of the falsity of the representations and justifiably and reasonably believed them to be true and relied  
14 thereon to their detriment.

15 247. As a proximate result of this fraud and deceit, Plaintiffs have suffered and will  
16 continue to suffer general and special damages in the form of, among other things, unfairly inflated  
17 payments on the SAVRS during the period of approximately December 2007 to June 2008, the exact  
18 amount of which will be proven at trial.

19 248. Fuld and O'Meara individually owed a duty of care, independent of Lehman Brothers'  
20 own duty, to refrain from acting in a manner that created an unreasonable risk of personal injury to  
21 third parties, including Lehman Brothers' counterparties such as Plaintiffs. On Plaintiffs'  
22 information and belief, Fuld and O'Meara had knowledge of and directed and/or approved of  
23 Lehman Brothers' manipulation of the auctions of the RHF Group's SAVRS, the transmittals to  
24 Plaintiffs of so-called auction results that in fact were based on unfair and undisclosed manipulation,  
25 and the resulting demands for payment. Further, Fuld and O'Meara were aware of the intentional  
26 auction manipulations and attendant misrepresentations and payment demands by Lehman Brothers,  
27 and ratified the continuance of this wrongful course of conduct. Lehman Brothers and its  
28 subsidiaries, which it controlled, operated in this manner under the Individual Lehman Defendants'

1 direction and authority. Moreover, Fuld and O'Meara accepted and retained the benefits of this  
2 conduct, as Plaintiffs' inflated payments increased profits for Lehman Brothers and allowed it to  
3 stave off bankruptcy longer than otherwise possible.

4 **TENTH CAUSE OF ACTION**

5 **(Intentional Interference with Prospective Economic Advantage By All Plaintiffs Against**  
6 **Fuld, O'Meara and Does 21-30)**

7 249. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
8 Complaint as though set forth in full at this point.

9 250. Plaintiffs had an economic relationship and prospective economic relationship with  
10 holders and potential holders of SAVRS that had a probability of future economic benefit to  
11 Plaintiffs. Plaintiffs expected to obtain financing through the SAVRS at rates which reasonably  
12 reflected market rates and were the result of fairly and properly conducted SAVRS auctions, through  
13 which the returns that holders and potential holders received on the SAVRS would be determined.

14 251. Lehman Brothers was aware of this relationship.

15 252. On Plaintiffs' information and belief, from approximately December 2007 through  
16 June 2008, Lehman Brothers intentionally manipulated the RHF Group's SAVRS auctions and made  
17 the above-described representations regarding the purported results of the SAVRS auctions,  
18 including how much Plaintiffs purportedly owed, with the design of disrupting Plaintiffs'  
19 relationship with holders and potential holders of SAVRS by grossly inflating the rates that Plaintiffs  
20 purportedly owed on the SAVRS.

21 253. Lehman Brothers' conduct and misrepresentations actually disrupted Plaintiffs'  
22 relationship with holders and potential holders of SAVRS by grossly inflating the rates that Plaintiffs  
23 purportedly owed on the SAVRS.

24 254. As a proximate result of Lehman Brothers' intentional interference, Plaintiffs have  
25 suffered and will continue to suffer general and special damages in the form of, among other things,  
26 unfairly inflated payments on the SAVRS during the period of approximately December 2007 to  
27 June 2008, the exact amount of which will be proven at trial.

28 255. On Plaintiffs' information and belief, Fuld and O'Meara had knowledge of and



1 directed and/or approved of Lehman Brothers' intentional manipulation of the auctions of the RHF  
2 Group's SAVRS, the intentional transmittals to Plaintiffs of so-called auction results that in fact  
3 were based on unfair and undisclosed manipulation, and the resulting demands for payment. Further,  
4 Fuld and O'Meara were aware of the intentional auction manipulations and attendant  
5 misrepresentations and payment demands by Lehman Brothers, and ratified the continuance of this  
6 wrongful course of conduct. Lehman Brothers and its subsidiaries, which it controlled, operated in  
7 this manner under the Individual Lehman Defendants' direction and authority. Moreover, Fuld and  
8 O'Meara accepted and retained the benefits of this conduct, as Plaintiffs' inflated payments increased  
9 profits for Lehman Brothers and allowed it to stave off bankruptcy longer than otherwise possible.

10 256. On Plaintiffs' information and belief, in making, directing, approving, and/or ratifying  
11 the above-described intentional interference, Fuld and O'Meara acted with fraud, oppression and  
12 malice, in that their conduct was despicable and was carried on with a willful and conscious  
13 disregard for the rights of Plaintiffs; and in that their conduct subjected Plaintiffs to cruel and unjust  
14 hardship in conscious disregard of their rights or otherwise causing injury to Plaintiffs. On  
15 Plaintiffs' information and belief, Fuld and O'Meara had advance knowledge and authorized and  
16 ratified these acts of fraud, oppression and malice performed by themselves. Thus, Plaintiffs are  
17 therefore entitled to the assessment of punitive damages against Fuld and O'Meara in an amount to  
18 be proven at trial.

19 **ELEVENTH CAUSE OF ACTION**

20 **(Fraud And Deceit By All Plaintiffs Against**

21 **The Individual Lehman Defendants and Does 21-140)**

22 257. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
23 Complaint as though set forth in full at this point.

24 258. Prior to and at the time Plaintiffs entered into the 2008 Swap Contract, the Individual  
25 Lehman Defendants made and assumed the above-described representations regarding, among other  
26 things, Lehman Brothers' financial condition, its strength, stability and viability. However, at the  
27 time these representations were made, they were in fact false and deceptive and concealed material  
28 facts, and these statements and fraudulent concealments were known to be false and misleading by

1 the Individual Lehman Defendants. The Individual Lehman Defendants made, ratified and/or  
2 authorized this fraud and concealment with the express intent of causing counterparties like Plaintiffs  
3 to rely thereon.

4 259. The Individual Lehman Defendants were aware of materially adverse facts concerning  
5 Lehman Brothers' financial condition, mortgage-backed asset portfolio and the mortgage markets  
6 in general that threatened its continued existence. Despite such knowledge, the Individual Lehman  
7 Defendants failed to take the necessary steps to lower Lehman Brothers' exposure or disclose the  
8 risks and consequences of its conduct to Plaintiffs. The misrepresentations about Lehman Brothers'  
9 financial strength and concealment of materially adverse facts about Lehman Brothers' financial  
10 condition were done with the knowledge and approval of the Individual Lehman Defendants, and  
11 Lehman Brothers operated in this manner under their direction and authority.

12 260. On Plaintiffs' information and belief, these misrepresentations and concealments were  
13 made with the intent to deceive Plaintiffs and similarly situated entities and to induce them to agree  
14 to pay Lehman Brothers more than it was actually owed and to continue to enter into or maintain  
15 long-term agreements with Lehman Brothers and avoid and cover up Lehman Brothers' default  
16 under agreements such as the 1998 Swap.

17 261. In June 2008, in reliance on Lehman Brothers' representations regarding the swap  
18 valuations and its financial strength, stability and viability, the RHF Group, St. Catherine and  
19 DeSmet terminated the 1998 Swap and related swaps and renegotiated a new, long term swap  
20 agreement with Lehman Brothers in connection with the refinanced bonds, in which Lehman  
21 Brothers unconditionally guaranteed Plaintiffs' variable interest and capital payment obligations on  
22 the refinanced bonds that were subject to the agreement.

23 262. Plaintiffs, at the time the above-described representations were made, were ignorant  
24 of the falsity of the representations and justifiably and reasonably believed them to be true and relied  
25 thereon to their detriment.

26 263. In justifiable reliance on the representations and concealments made by the Individual  
27 Lehman Defendants, Plaintiffs were induced to enter the 2008 Swap and paid Lehman Brothers and  
28 others fees for, among other things, the 2008 Swap, which was unfairly valued in favor of Lehman

1 Brothers.

2 264. On Plaintiffs' information and belief, all of the Individual Lehman Defendants, each  
3 of whom was an officer and/or director of Lehman Brothers, had knowledge of and directed and/or  
4 approved of Lehman Brothers' misrepresentations regarding its financial strength and concealment  
5 of materially adverse facts regarding its financial condition. Lehman Brothers and its subsidiaries,  
6 which it controlled, operated in this manner under the Individual Lehman Defendants' direction and  
7 authority. Moreover, the Individual Lehman Defendants accepted and retained the benefits of this  
8 conduct, as Plaintiffs' fees and payments with respect to the 2008 Swap increased profits for Lehman  
9 Brothers and allowed it to stave off bankruptcy longer than otherwise possible, thereby allowing the  
10 Individual Lehman Defendants to increase and extend their compensation.

11 265. As a proximate result of the Individual Lehman Defendants' fraud and deceit,  
12 Plaintiffs have suffered and will continue to suffer general and special damages in the form of,  
13 among other things, fees and payments for the 2008 Swap and lost benefits under the 1998 Swap and  
14 the 2008 Swap, the exact amount of which will be proven at trial.

15 266. On Plaintiffs' information and belief, in making the above-described representations,  
16 the Individual Lehman Defendants, as the officers and directors of Lehman Brothers, acted with  
17 fraud, oppression and malice, in that their conduct was despicable and was carried on with a willful  
18 and conscious disregard for the rights of Plaintiffs; and in that their conduct subjected Plaintiffs to  
19 cruel and unjust hardship in conscious disregard of their rights or otherwise causing injury to  
20 Plaintiffs. On Plaintiffs' information and belief, each of the Individual Lehman Defendants had  
21 advance knowledge and authorized and ratified these acts of fraud, oppression and malice performed  
22 by themselves. Thus, Plaintiffs are therefore entitled to the assessment of punitive damages against  
23 the Individual Lehman Defendants in an amount to be proven at trial.

24 **TWELFTH CAUSE OF ACTION**

25 **(Negligent Misrepresentation By All Plaintiffs Against**  
26 **The Individual Lehman Defendants and Does 21-140)**

27 267. Plaintiffs hereby repeat and re-allege Paragraphs 1 through 185 of this Sixth Amended  
28 Complaint as though set forth in full at this point.

1           268. Prior to and at the time Plaintiffs entered into the 2008 Swap, the Individual Lehman  
2 Defendants made and assumed the above-described representations regarding, among other things,  
3 Lehman Brothers' financial condition, stability and viability. However, at the time these  
4 representations were made, the Individual Lehman Defendants had no reasonable grounds for  
5 believing these representations to be true.

6           269. Lehman Brothers' officers and directors were aware of materially adverse facts  
7 concerning Lehman Brothers' financial condition, mortgage-backed asset portfolio and the mortgage  
8 markets in general that threatened its continued existence. Despite such knowledge, Lehman  
9 Brothers' officers and directors failed to take the necessary steps to lower Lehman Brothers'  
10 exposure or disclose the risks and consequences of its conduct to Plaintiffs. The misrepresentations  
11 about Lehman Brothers' financial strength and failures to disclose materially adverse facts about  
12 Lehman Brothers' financial condition were done with the knowledge and approval of the Individual  
13 Lehman Defendants, and Lehman Brothers operated in this manner under their direction and  
14 authority.

15           270. On Plaintiffs' information and belief, these misrepresentations and failures to disclose  
16 were made with the intent to induce Plaintiffs and similarly situated entities to agree to pay Lehman  
17 Brothers more than it was actually owed and to continue to enter into long-term agreements with  
18 Lehman Brothers.

19           271. In June 2008, in reliance of Lehman Brothers' representations regarding its financial  
20 strength, stability and viability, the RHF Group, St. Catherine and DeSmet terminated their old swap  
21 agreements and renegotiated a new, long term swap agreement with Lehman Brothers in connection  
22 with the refinanced bonds, in which Lehman Brothers unconditionally guaranteed Plaintiffs' variable  
23 interest and capital payment obligations on the refinanced bonds that were subject to the agreement.

24           272. Plaintiffs, at the time the above-described representations were made, were ignorant  
25 of the falsity of the representations and justifiably and reasonably believed them to be true and relied  
26 thereon to their detriment.

27           273. In justifiable reliance on the representations made by the Individual Lehman  
28 Defendants, Plaintiffs were induced to enter the 2008 Swap and paid Lehman Brothers and others

1 fees for, among other things, the 2008 Swap, which was unfairly valued in favor of Lehman  
2 Brothers.

3 274. All of the Individual Lehman Defendants, each of whom was an officer and/or  
4 director of Lehman Brothers, individually owed a duty of care, independent of Lehman Brothers'  
5 own duty, to refrain from acting in a manner that created an unreasonable risk of injury to third  
6 parties, including Lehman Brothers' counterparties such as Plaintiffs. On Plaintiffs' information and  
7 belief, all of the Individual Lehman Defendants, each of whom was an officer and/or director of  
8 Lehman Brothers, had knowledge of and directed and/or approved of Lehman Brothers'  
9 misrepresentations regarding its financial strength and its failure to disclose materially adverse facts  
10 regarding its financial condition. Lehman Brothers and its subsidiaries, which it controlled, operated  
11 in this manner under the Individual Lehman Defendants' direction and authority. Moreover, the  
12 Individual Lehman Defendants accepted and retained the benefits of this conduct, as Plaintiffs' fees  
13 and payments with respect to the 2008 Swap increased profits for Lehman Brothers and allowed it  
14 to stave off bankruptcy longer than otherwise possible, thereby allowing the Individual Lehman  
15 Defendants to increase and extend their compensation.

16 275. As a proximate result of the Individual Lehman Defendants' negligent  
17 misrepresentations, Plaintiffs have suffered and will continue to suffer general and special damages  
18 in the form of, among other things, fees and payments for the 2008 Swap and lost benefits under the  
19 2008 Swap, the exact amount of which will be proven at trial.

20 WHEREFORE, Plaintiffs pray for judgment against Cain Brothers, ACA, and the Individual  
21 Lehman Defendants as follows:

22 On the First Cause of Action:

- 23 1. For compensatory damages, according to proof, but in excess of \$20,000,000.

24 On the Second Cause of Action:

- 25 1. For compensatory damages, according to proof, but in excess of \$20,000,000.

26 On the Third Cause of Action:

- 27 1. For compensatory damages, according to proof, but in excess of \$20,000,000.  
28 2. For exemplary and punitive damages, according to proof.

1 On the Fourth Cause of Action:

- 2 1. For compensatory damages, according to proof, but in excess of \$20,000,000.  
3 2. For exemplary and punitive damages, according to proof.

4 On the Fifth Cause of Action:

- 5 1. For compensatory damages, according to proof, but in excess of \$20,000,000.  
6 2. For exemplary and punitive damages, according to proof.

7 On the Sixth Cause of Action:

- 8 1. For compensatory damages, according to proof, but in excess of \$20,000,000.

9 On the Seventh Cause of Action:

- 10 1. For such amount as ACA has been unjustly enriched as a result of its tortious conduct  
11 toward the RHF Group.

12 On the Eighth Cause of Action:

- 13 1. For compensatory damages, according to proof, but in excess of \$10,000,000.  
14 2. For exemplary and punitive damages, according to proof.

15 On the Ninth Cause of Action:

- 16 1. For compensatory damages, according to proof, but in excess of \$10,000,000.

17 On the Tenth Cause of Action:

- 18 1. For compensatory damages, according to proof, but in excess of \$10,000,000.  
19 2. For exemplary and punitive damages, according to proof.

20 On the Eleventh Cause of Action:

- 21 1. For compensatory damages, according to proof, but in excess of \$20,000,000.  
22 2. For exemplary and punitive damages, according to proof.

23 On the Twelfth Cause of Action:

- 24 1. For compensatory damages, according to proof, but in excess of \$20,000,000.

25 On All Causes of Action:

- 26 1. That Plaintiffs be awarded their costs;  
27 2. That Plaintiffs be awarded reasonable attorney's fees pursuant to contract and/or law;  
28 3. That Plaintiffs be awarded pre-judgment and post-judgment interest as permitted by

1 law; and

2 4. For such other relief as this Court deems just and proper.

3  
4 DATED: August 7, 2013

REUBEN RAUCHER & BLUM

5  
6 By: 

Timothy D. Reuben  
Attorneys for Plaintiffs

**DEMAND FOR JURY TRIAL**

The Plaintiffs demand a trial by jury of all issues and claims in this action triable before a jury.

DATED: August 7, 2013

REUBEN RAUCHER & BLUM

By:   
Timothy D. Reuben  
Attorney for Plaintiffs